UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

JINO KURIAKOSE, Individually and On Behalf of All Others Similarly Situated, Plaintiff, vs. FEDERAL HOME LOAN MORTGAGE COMPANY, RICHARD SYRON, PATRICIA L. COOK, and ANTHONY S. PISZEL, Defendants.	x : : : : : : : : : : : : x	Civil Action No. 1:08-cv-7281 (JFK) **AMENDED CONSOLIDATED CLASS ACTION COMPLAINT FOR VIOLATIONS OF FEDERAL SECURITIES LAWS** **JURY TRIAL DEMANDED**

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1. Lead Plaintiff Central States, Southeast and Southwest Areas Pension Fund and plaintiff National Elevator Industry Pension Plan (collectively, "Plaintiffs"), by and through their undersigned counsel, individually and on behalf of a proposed class (the "Class") of all purchasers of Federal Home Loan Mortgage Corporation ("Freddie Mac" or the "Company") (NYSE: FRE) equity securities between November 20, 2007 through and including September 7, 2008, inclusive (the "Class Period"), including common and preferred stock, bring suit against Freddie Mac, Richard Syron ("Syron"), Patricia L. Cook ("Cook"), and Anthony S. Piszel ("Piszel") (Freddie Mac, Syron, Cook, and Piszel are sometimes collectively referred to as "Defendants").

2. Plaintiffs seek remedies under the Securities Exchange Act of 1934 (the "Exchange Act") as a result of the fraudulent scheme undertaken by Defendants and the economic loss suffered when the Company's true financial circumstances and future business prospects were revealed to the public through a series of partial disclosure events that corrected market expectations for the Company. The claims asserted herein arise under and pursuant to Sections 10(b) and 20(a) of the Exchange Act, 15 U.S.C. §§78j(b) and 78t(a), and Rule 10b-5 promulgated thereunder, 17 C.F.R. §240.10b-5.

I. INTRODUCTION AND NATURE OF THE ACTION

3. Plaintiffs bring this case because Defendants artificially inflated the value of Freddie Mac equity securities throughout the Class Period by continuously and consistently assuring the market the Company had minimal exposure to the non-prime and non-traditional lending markets. Defendants also failed to disclose substantial and ongoing problems with the Company's capital adequacy (a key financial and regulatory metric), manipulating Freddie Mac's financial results and accounting practices in a manner designed to avoid taking losses that should have been taken in earlier reporting periods, which had the effect of making the Company appear more profitable than it was and distorting the truth regarding its financial health and future business

prospects. In so doing, and through their materially false and misleading statements detailed herein, Defendants were not only able to artificially inflate the price of the Company's equity securities by manipulating market expectations, but also forestalled the day when that artificial inflation would come out of the stock. When the truth about the Company's finances and future business prospects were revealed through a series of partial disclosures, market expectations were corrected and the purchasers of Freddie Mac's equity securities suffered billions of dollars in losses.

4. The Class Period starts on November 20, 2007, when Freddie Mac reported losses of more than $2 billion for the third quarter of 2007 ("3Q2007"). This news had a tremendous impact on the Company and the price of its common and preferred stock. For example, Freddie Mac common stock fell from $37.50 to $26.74. Those partial revelations, however, were only the tip of the proverbial iceberg. What lurked beneath the surface at Freddie Mac was far more destructive, and Defendants knew it. Rather than come clean, Defendants embarked on a fraudulent scheme designed to mislead the market and artificially inflate the Company's stock price, spinning the disclosure of the 3Q2007 loss in order to minimize its impact and preserve the additional artificial inflation in the Company's stock price. It worked – until the Company literally sank under the weight of its horrendous financial condition and Defendants' fraudulent scheme was ultimately revealed.

5. To be clear, while Freddie Mac announced the 3Q2007 loss on November 20, 2007, neither the announcement nor the accompanying decline in the value of the Company's equity securities are the subject of this case. Rather, Defendants attempted to negate, or, at the very least, minimize the impact of the $2 billion loss by misleading the market as to the Company's long-term viability and future business prospects. It is these false and misleading statements that mark the start of the Class Period.

6. From the start of the Class Period, Freddie Mac was the epitome of a "wolf in sheep's clothing." During this time, Defendants touted Freddie Mac as one of the potential saviors of the housing market, openly lobbying for the government to allow the Company to buy more and larger mortgages, pressuring the Company's regulator, the Office of Federal Housing Enterprise Oversight ("OFHEO"), to lower mandatory surplus capital requirements and mortgage portfolio caps, and stressing the Company's ability to provide liquidity and stability to a faltering housing market. Cook, the Company's Chief Business Officer, was quoted in a July 5, 2007 *Economist* article as stating, "***[t]his is a time when Fannie and Freddie can prove their worth as market stabilizers.***"[1]

7. At the same time, Defendants consistently reassured investors as to the soundness of Freddie Mac's mortgage portfolio (continually representing that the Company's financial exposure to the floundering subprime and non-prime mortgage markets was virtually non-existent), the adequacy of its underwriting and risk management, and, importantly, the sufficiency of its capital. For instance, on November 20, 2007, Syron stated during an earnings conference call that ***"through the third quarter, our credit position has remained among the strongest in an admittedly troubled industry and the conventional conforming market, where the vast majority of our exposure is, has held up well."*** Similarly, on November 20, 2007, Piszel touted the Company's ***"tightened"*** credit standards and enhanced risk management. On December 11, 2007, Syron told investors ***"what's important for us is the decline that occurs in the prime conventional space - not in the jumbo space and not in the subprime space and not largely in the investor space - but in the prime conventional space,"*** and later on that same call that ***"we didn't buy any subprime loans …***

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[1] Unless indicated otherwise herein, all emphasis is added.

we weren't in that business." On May 14, 2008, Piszel advised investors that Freddie Mac "***remain[ed] in a strong and sound capital position."*** Even as late as July 11, 2008, Defendants continued to conceal that Freddie Mac was so inadequately capitalized that it needed billions of dollars in government aid by issuing a press release stating ***"Freddie Mac is not on the threshold of conservatorship because we are adequately capitalized."*** Defendants repeated this mantra into August 2008, allaying investors' fears by adamantly claiming the Company was capitalized for the foreseeable future and had the ability to raise additional capital, if needed.

8. All the while, contrary to the picture they misleadingly created for the market, Defendants knew the Company's massive exposure to mortgage-related losses, poor underwriting standards, and risk management procedures were disastrously impacting the Company's capital adequacy. Instead of having the minimal exposure Defendants repeatedly trumpeted, Freddie Mac was in a position of precarious exposure and risk.

9. In particular, Defendants immersed the Company in dangerous non-prime and non-traditional loans, including "Alt-A" loans, given to borrowers with slightly better-than-subprime credit scores, but with little to no documentation supporting their ability to actually pay the mortgage. Defendants leveraged the Company's entire financial well-being on toxic loans, exposing unwitting investors to untold credit risks the Company was incapable of evaluating, even though Defendants claimed they could. At the same time, Defendants minimized and delayed the Company's financial reporting of Freddie Mac's true non-prime and non-traditional loan exposure, concealing existing, massive losses to maintain the mirage of an adequate capital cushion, which is a crucial financial safety net Freddie Mac was required by OFHEO to maintain to protect the Company against a downturn in housing prices or other financial losses. Defendants, however,

concealed a tidal wave of losses that decimated the Company, wiped out its capital cushion, and effectively rendered the Company insolvent toward the close of the Class Period.

10. Indeed, Defendants received internal warnings ***as early as 2004*** that Freddie Mac's shoddy underwriting standards, virtually non-existent risk management procedures and resulting purchase of junk mortgages and mortgage-backed securities ("MBS") left it exposed to immense losses. In mid-2004, David A. Andrukonis ("Andrukonis"), Freddie Mac's Chief Risk Officer until 2005, told Syron the Company was buying bad loans that ***"would likely pose an enormous financial and reputational risk to the company and the country."*** For his efforts, Andrukonis was fired. Around that same time, Syron received a memorandum stating Freddie Mac's underwriting standards were becoming shoddier and the Company was exposed to dynamically large financial losses.

11. Despite all of this, including Defendants' knowledge and/or reckless disregard for the insufficiency of Freddie Mac's capital base, Defendants falsely reassured investors as to the soundness of Freddie Mac's mortgage portfolio, its underwriting and risk management, and the adequacy of its capital. Defendants claimed the Company had very limited non-prime and non-traditional mortgage risk. Thus, as demonstrated more fully below, Defendants' Class Period statements were materially false and misleading when made.

12. Throughout the deterioration of the housing market in 2007 (due in large part to the very non-prime and non-traditional mortgage boom Freddie Mac helped create), Freddie Mac's huge exposure to subprime and other non-prime and non-traditional mortgages and thin capitalization left it in an increasingly perilous financial position. Freddie Mac's (concealed) exposure was so profound it was forced to sell in an offering (the "Offering") approximately 240 million shares of preferred stock for $6.5 billion. Defendants assured the market the proceeds of the Offering would

put the Company on sound financial footing. The truth was, however, that the Offering proceeds did little more than conceal a $3 billion dollar loss due to the Company's extremely risky non-prime and non-traditional investment activities. As housing prices plummeted and borrowers defaulted in droves, Defendants continued to mislead investors as to Freddie Mac's true exposure to mortgage-related losses and the resulting negative effects on its capital.

13. The impact of Freddie Mac's massive losses on its mortgage holdings and failure to maintain an adequate capital base was beyond dire: the Company fell into such feeble condition the federal government assumed control over Freddie Mac and placed it into conservatorship on September 7, 2008 – notwithstanding Defendants' insistence less than two months earlier that the Company had all the capital it needed and was not on the threshold of conservatorship – and bailed it out with approximately $14 billion in taxpayer-financed money.[2] As in Aesop's timeless fable, the "wolf" was ultimately discovered for what it was – a fraud:

- ***"They found out [Fannie Mae and Freddie Mac] had a house of cards. . . once [the U.S. Treasury Department] got someone looking closely at Fannie and Freddie's books, they realized there just wasn't adequate capital there."***

  -- U.S. Senator Richard Shelby, in an interview with *Bloomberg*, September 8, 2008

- ***". . . the [Fannie Mae and Freddie Mac] propaganda machine purposefully misled people into believing that it was keeping risk low and operating under an adequate prudential regulatory regime."***

  -- *The Last Trillion Dollar Commitment – The Destruction of Fannie Mae and Freddie Mac*, Peter J. Wallison, the Arthur F. Burns Fellow in Financial Policy Studies at the American Enterprise Institute, and Charles W. Calomiris, the Henry Kaufman Professor of Financial Institutions at Columbia Business School, January 25, 2009

[2] The $14 billion price tag has since ballooned into $51.7 billion. As recently as May 12, 2009, Freddie Mac stated that it needed $6.1 billion in additional bailout monies from the federal government.

- ***"In retrospect and despite OFHEO's surplus capital requirements, portfolio caps, and repeated warnings about credit risks, the credit profile of both [Freddie Mac and Fannie Mae] followed the market down in 2006 and 2007 – without commensurate pricing for risk."***

-- Written Statement of the Honorable James B. Lockhart, III, Director of the Federal Housing Finance Agency, before the Senate Committee on Banking, Housing and Urban Affairs, September 23, 2008

14. The end of the Class Period discovery of Defendants' massive, orchestrated fraud comes as no consolation to Plaintiffs and Class members, who lost billions of dollars due to Defendants' wrongful acts. On November 20, 2007, the first day of the Class Period, the trading price of Freddie Mac common stock closed at $26.74 and the various series of preferred shares closed at between $17.09 and $50.50.[3] As Defendants issued a plethora of false and misleading statements designed to minimize, misrepresent, and cloak the Company's exposure to non-traditional and non-prime mortgages, as well as assure the market as to the soundness of the Company's capital adequacy, the price of the Company's equity securities rose and buoyed what would have been additional price declines. For example, by December 6, 2007, Defendants' false and misleading

[3] Freddie Mac's preferred securities include the April 23, 1996 Variable-Rate Preferred Stock Offering (FRE.prB) ("Series B"); March 18, 1998 5% Preferred Stock Offering (FRE.prF) ("Series F"); September 18, 1998 5.1% Preferred Stock Offering (FRE.prH) ("Series H"); September 18, 1998 Variable-Rate Preferred Stock Offering (FRE.prG) ("Series G"); July 16, 1999 5.79% Preferred Stock Offering (FRE.prK) ("Series K"); November 2, 1999 Variable-Rate Preferred Stock Offering (FRE.prL) ("Series "L"); January 23, 2001 Variable-Rate Preferred Stock Offering (FRE.prM) ("Series "M"); March 20, 2001 Variable-Rate and 5.81% Preferred Stock Offering (FRE.prN) (FRE.prO) ("Series N," "Series O," respectively); May 23, 2001 Variable-Rate and 6% Preferred Stock Offering (FRE.prP) (FRE.prQ) ("Series P," "Series Q," respectively); October 25, 2001 5.7% Preferred Stock Offering (FRE.prR) ("Series R"); July 12, 2006 Variable-Rate and 6.42% Preferred Stock Offering (Fre.prS) (FRE.prT) ("Series S," "Series T," respectively); October 11, 2006 5.9% Preferred Stock Offering (FRE.prU) ("Series U"); January 10, 2007 5.57% Preferred Stock Offering (FRE.prV) ("Series V"); April 10, 2007 5.66% Preferred Stock Offering (FRE.prW) ("Series W"); July 17, 2007 6.02% Preferred Stock Offering (FRE.prX) ("Series "X"); September 24, 2007 6.55% Preferred Stock Offering (FRE.prY) ("Series "Y"); and November 29, 2007 Fixed-to-Floating Rate Preferred Stock Offering (FRE.prZ) ("Series Z"). Each of the Company's preferred series traded on the New York Stock Exchange during the Class Period.

statements were successful in pushing the price of Freddie Mac common stock to a close of $37.10, and then a high price of $37.18 the following day, representing nearly a 39% increase from the start of the Class Period. The preferred stock also increased as much as 3% per share. Although the common stock fell to $17.39 per share on March 10, 2008, Defendants' fraud had the cause and effect of propping it back up to a closing price of $32.58 on March 20, 2008, a mere 10 days later, representing an increase of ***87%*** on historic gains. The Company's preferred stock experienced similar price movements, increasing by as much as 14% per share.

15. Despite their best efforts, Defendants could not hide the truth forever. Indeed, even in the face of Defendants' ongoing efforts to mislead the market, investors slowly began to realize, amongst a tidal wave of negative news, that the Company was drowning in a sea of non-prime and non-traditional mortgage loan exposure, and that it was so inadequately capitalized as to be insolvent. Indeed, on July 15, 2008, on a cacophony of negative news and a dramatic increase in trading activity of nearly 400 million common shares (a more than ***8,000%*** increase of the average trading volume of approximately 4.8 million shares for the Company's common stock since 1988), Freddie Mac common stock hit a low of $4.68 before closing at $5.26 per share, representing an ***86%*** drop from the Class Period high.[4] Likewise, the various classes of Freddie Mac's preferred shares sharply dropped at the same time, falling to a low of between $5.20 and $26.54 on July 15, 2008.

16. Although the trading price of Freddie Mac equity securities recovered for a short time as Defendants made additional false and misleading statements, additional information concerning the Company's true financial condition and future business prospects was revealed on

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[4] When compared to the average trading volume during the Class Period, the July 15, 2008 trading activity in Freddie common stock represented nearly a ***1,300%*** increase in trading volume.

August 6, 2008, when Freddie Mac common stock dropped ***19%*** to close at $6.49 per share – representing an 83% fall from its Class Period highs. Classes of Freddie Mac preferred stock fell as well, dropping as much as 12% to fall as much as 50% from Class Period highs. By the time the federal government had no choice but to impose a conservatorship over Freddie Mac, the common stock was nearly worthless, trading at $0.88 per share on September 8, 2008. Likewise, the preferred shares fell as much as 87%. Freddie Mac equity securities have not recovered. In light of the foregoing, Plaintiffs bring this action seeking to recover the billions of dollars in damages caused by Defendants' violations of federal securities laws.

II. JURISDICTION AND VENUE

17. This Court has jurisdiction over the subject matter of this action pursuant to §27 of the Exchange Act, 15 U.S.C. §78aa, and 28 U.S.C. §1331.

18. Venue is proper in the Judicial District pursuant to §27 of the Exchange Act, 15 U.S.C. §78aa, and 28 U.S.C. §1391(b). Many of the acts in furtherance of the alleged fraud and/or the effects of the fraud occurred within this District.

19. In connection with the acts, conduct, and other wrongs alleged in this Complaint, Defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, including but not limited to, the United States mails, interstate telephone communications, and the facilities of the national securities markets.

III. THE PARTIES

20. Plaintiff Central States Southeast and Southwest Areas Pension Fund was appointed Lead Plaintiff on November 24, 2008, and is one of the nation's largest Taft-Hartley funds, with approximately 10,000 active participants and more than $26 billion in assets as of year-end 2007. Central States purchased 932,709 shares of Freddie Mac common stock during the Class

Period at artificially inflated prices and was damaged thereby as the Company's true financial condition was revealed.

21. Plaintiff National Elevator Industry Pension Plan (the "Fund") provides retirement benefits to individuals employed in the elevator industry whose employment is governed by a collective bargaining agreement requiring contributions to the Fund. The Fund has more than 40,000 participants and more than $4 billion in assets. The Fund purchased 361,876 shares of Freddie Mac common stock and 120,600 shares of Freddie Mac preferred stock at artificially inflated prices and was damaged thereby as the Company's true financial condition was revealed.

22. Defendant Freddie Mac is a government-sponsored enterprise ("GSE") with its principal place of business located at 8200 Jones Branch Drive, McLean, Virginia. A GSE is a government-chartered, privately-owned and privately controlled institution that, while lacking an express government guarantee, benefits from the perception that the government stands behind its financial obligations. Freddie Mac was chartered by Congress in 1970 to stabilize the nation's residential mortgage markets and expand opportunities for home ownership and affordable rental housing. Freddie Mac is owned by the Company's shareholders, and the Company's equity securities were listed and traded on the New York Stock Exchange during the Class Period.

23. Defendant Richard F. Syron ("Syron") served as Chairman of the Board and Chief Executive Office ("CEO") of Freddie Mac from December 2003 until October 2008, when he was relieved of his duties after the federal government placed Freddie Mac into conservatorship.

24. Defendant Anthony S. Piszel ("Piszel") served as Freddie Mac's Executive Vice president and Chief Financial Officer ("CFO") from November 13, 2006 until September 22, 2008 when he was fired "without cause."[5]

25. Throughout the Class Period, Syron and Piszel were responsible for ensuring the accuracy of Freddie Mac's public filings and other public statements, and they both personally attested to and certified the accuracy of Freddie Mac's financial statements. During the Class Period – specifically on November 20, 2007, February 28, 2008, May 14, 2008 and August 6, 2008 – Syron and Piszel each signed certifications included in the Company's public filings stating:

> 1. I have reviewed this Information Statement of the Federal Home Loan Mortgage Corporation, or Freddie Mac;
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> 2. Based on my knowledge, this Information Statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Information Statement; and
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> 3. Based on my knowledge, the consolidated financial statements, and other financial information included in this Information Statement, fairly present in all material respects the financial condition, results of operations and cash flows of Freddie Mac as of, and for, the periods presented in this Information Statement.

26. Defendant Patricia L. Cook ("Cook") was Freddie Mac's Chief Business Officer and Executive Vice President for Investments and Capital Markets from June 2007 until November 17, 2008. Cook joined Freddie Mac on August 2, 2004. Among other things, Cook made numerous false and misleading statements in conference calls during the Class Period.

27. Defendants Syron, Piszel and Cook are collectively referred to herein as the "Individual Defendants."

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[5] Seven members of Freddie Mac's Board of Directors resigned during that same week.

28. Each of the Individual Defendants made knowingly false and misleading statements concerning, *inter alia*, Freddie Mac's financial performance, capital adequacy and risk exposure in the Company's quarterly and annual earnings conference calls, during interviews with the media, and in other public presentations and speeches.

IV. CLASS ACTION ALLEGATIONS

29. Plaintiffs bring this action as a class action pursuant to Federal Rules of Civil Procedure 23(a) and (b)(3) on behalf of a Class, consisting of all those who purchased Freddie Mac equity securities during the Class Period. Excluded from the Class are Defendants, the officers and directors of the Company, members of their immediate families and their legal representatives, heirs, successors, or assigns, and any entity in which Defendants have or had a controlling interest.

30. Because Freddie Mac has hundreds of millions of shares of equity outstanding, and because the Company's shares were actively traded on the NYSE, members of the Class are so numerous that joinder of all members is impracticable. According to Freddie Mac's SEC filings, as of July 28, 2008 (shortly before the close of the Class Period), Freddie Mac had more than 647 million shares of common stock outstanding and hundreds of millions of additional shares of the Series B, F, G, H, K, L, M, N, O, P, Q, R, S, T, U, V, W, X, Y, Z preferred stock outstanding. While the exact number of Class members can only be determined by appropriate discovery, Plaintiffs believe Class members number at least in the thousands and that they are geographically dispersed.

31. Plaintiffs' claims are typical of the claims of the members of the Class because Plaintiffs and all of the Class members sustained damages arising out of Defendants' wrongful conduct complained herein.

32. Plaintiffs will fairly and adequately protect the interests of the Class members and have retained counsel experienced and competent in class actions and securities fraud litigation.

Plaintiffs have no interests that are contrary to or in conflict with the members of the Class they seek to represent.

33. A class action is superior to all other available methods for the fair and efficient adjudication of this controversy, since joinder of all members is impracticable. Furthermore, as the damages suffered by individual members of the Class may be relatively small, the expense and burden of individual litigation make it impossible for the members of the Class to individually redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

34. Questions of law and fact common to the members of the Class predominate over any questions that may affect only individual members, in that Defendants have acted on grounds generally applicable to the entire Class. Among the questions of law and fact common to the Class are:

(a) Whether Defendants violated federal securities laws as alleged herein;

(b) Whether Defendants' publicly disseminated press releases and statements during the Class Period omitted and/or misrepresented material facts;

(c) Whether Defendants breached any duty to convey material facts or to correct material acts previously disseminated;

(d) Whether Defendants participated in and pursued the fraudulent scheme or course of business complained of;

(e) Whether Defendants acted willfully, with knowledge or severe recklessness, in omitting and/or misrepresenting material facts;

(f) Whether the market prices of Freddie Mac equity securities were artificially inflated during the Class Period due to the material nondisclosures and/or misrepresentations complained of herein; and

(g) Whether Plaintiffs and members of the Class sustained damages as a result of the decline in value of Freddie Mac equity securities when the truth was revealed and the artificial inflation came out and, if so, what is the appropriate measure of damages.

V. CONFIDENTIAL WITNESSES

35. Plaintiffs' allegations herein, concerning the falsity of Defendants' statements and the scienter of the Individual Defendants, are based, in part, on interviews with more than 100 former Freddie Mac employees and others with knowledge of the facts underlying Defendants' fraud. Throughout the course of the investigation of Defendants' fraud, many confidential former insiders provided corroborating information regarding the various methods employed by Defendants in furtherance of their scheme to defraud shareholders. In each instance, Plaintiffs have included sufficient facts to demonstrate the confidential witnesses discussed herein were in a position to have knowledge of the facts attributed to them.

36. These confidential witnesses included a former Vice President of Investor Relations who worked for Freddie Mac for almost two decades, leaving during the first quarter of 2007. From 1999 until March 2007, this former employee worked in the Company's McLean, Virginia headquarters. She/he was in the organizational line that reported to Cook. During the last two years of this former employee's tenure, she/he reported directly to Mark Hanson ("Hanson"), the Vice President of Mortgage Lending, who oversaw the Investor Relations function, as well as the issuance of Single Class Securities and of Multiclass Securities. The Single Class Securities were

"vanilla" MBS Freddie Mac issues that used residential mortgage loans as their collateral.[6] Multiclass Securities, or Structured Securities, used MBS as their collateral. This former Vice President was responsible for meeting with and maintaining relationships with institutional investors who were actual or potential purchasers of Freddie Mac's issuances that had residential mortgage loans as collateral.

37. One confidential witness worked until the fourth quarter of 2008 as a Director of Operational Risk Management. This former employee stated Freddie Mac was an "appallingly run company" that often just pushed paper and was not capable of solving problems. She/he has knowledge of this because throughout her/his tenure with the Company, she/he was tasked with getting various risk mitigation plans in place, but these efforts failed as a result of a lack of attention from Piszel and Cook. For example, this former employee was responsible for implementing a "business continuity plan" to identify critical Company functions that could not be interrupted. Although she/he met with Piszel and Cook in January 2008 and February 2008, respectively, and each of them agreed with her/his finding regarding critical systems, there was ultimately a lack of attention and "nothing got done." Among other things, this employee attended two of the eight or nine "risk scenario" meetings that took place in approximately August 2007 and were held at the Company's office at 1551 Park Run Drive in McLean, Virginia. These meetings focused on identifying and mitigating risks facing the Company resulting from the subprime crash. Attendees at these meetings included Assistant Treasurer John Radwanski ("Radwanski"), Senior Vice President of Default Asset Management Ingrid Beckles ("Beckles"), Operational Risk Group Director Gareth Davies ("Davies"), and Director of Operational Risk Group Assessment Patrick McDermott

[6] An MBS is an asset-backed security or debt obligation representing a claim on the cash flows from mortgage loans, most commonly on residential property.

("McDermott"), among others. This former employee stated Davies was tasked with authoring a risk report that was the subject of the meetings, and that McDermott facilitated the running of the meetings. She/he stated Piszel and Cook, and possibly Syron, had to "sign off" on Davies' risk report. This former employee has knowledge that the risk report identified various risk indicators used to track the manifestation of the risks as the basis for triggering responses to the risks, and that the report accurately identified the implications of the subprime crash for the Company. She/he knows this because she/he witnessed the risk indicators and triggers materialize in late 2007 and early 2008. She/he also has knowledge that the risks identified came to fruition at the same time Piszel made public statements about the adequacy of the Company's capital, and that she/he "absolutely knew" from attendance at the August 2007 meetings that Freddie Mac's capital position was not adequate given the number of defaults materializing. She/he stated Piszel's Class Period statements regarding capital adequacy were "bulls**t" and blatantly untrue.

38. Another confidential witness worked as a Senior Program Director for Information Services in the Company's Single Family Operations at the McLean, Virginia headquarters. She/he was employed by the Company for almost two decades, until the third quarter of 2007. This former employee provided support to Single Family Operations, including support for software programs, databases, and other tools used to acquire and price new loans, and assess the risk of loans held in the Company's retained portfolio. She/he reported to various Vice Presidents, including Don Bisenius ("Bisenius"), Patricia McClung, and Chris Morris. Her/his director supervisor, at one time, was Executive Vice President for Operations and Technology Joseph Smialowski. This former employee engineered the Company's Loan Prospector software system which was designed to be an automated, electronic system used to analyze risk in mortgage loans.

39. Another confidential witness was a former Senior Examiner of Credit Risk with OFHEO in Washington, D.C. from late 2004 through mid-2008. She/he was assigned to examine Freddie Mac during her/his entire tenure with OFHEO, and has knowledge concerning, among other things, OFHEO's total lack of real oversight and control of Freddie Mac, and how the Company was not actually in compliance with its own policies concerning credit risk.

40. Another former Freddie Mac employee worked as a Financial Analyst Manager, or Accountant, from approximately late 2003 until the fourth quarter of 2008. She/he was assigned to work on accounting for the Company's delinquent loans, which fell under the Company's Non-Performing Loans group and were part of the Single-Family Operations business line. This former employee also handled accounting for all Real Estate Owned ("REO") properties and related charge-offs. She/he worked with two other people buying back from investors loans that were more than 120 days in default, and also performed accounting for credit enhancements (insurance) on loans.

41. The confidential witnesses also include a former Senior Servicing Default Specialist working with the Company's Non-Performing Loan division of Single-Family Operations. This former employee worked for Freddie Mac for over two decades until approximately the third quarter of 2008. This former employee said the Non-Performing Loan division was comprised of between 20 and 50 people, and was divided into different units, and she/he worked in the "Loss Mitigation" or "File Quality Review" unit. This former employee's job entailed monitoring loans in default and working with banks and borrowers to keep people in their homes. She/he also "audited" delinquent loans Freddie Mac purchased from banks to hold in its portfolio and to sell on the open market. The former Senior Servicing Default Specialist has knowledge concerning reports on non-performing loans that were forwarded to various executives, including Syron, as well as the large increase in mortgage defaults and mortgages going into foreclosure during 2006.

42. Another confidential witness was a former Senior Business Application Project Manager at the Company's McLean, Virginia headquarters from 2000 through the first quarter of 2008. This former employee was a member of the Finance Division, which, like the rest of the Company, was subject to nearly constant, complex reorganization. She/he said although the Company had a complex structure, there were two major reporting lines under the CEO – the CFO and Chief Investment Officer ("CIO"), and these lines separated the Company into the so-called "finance side" and the "investment side." This former employee was assigned to Piszel's management reporting group during Piszel's time as Freddie Mac's CFO. The former Senior Business Application Project Manager reported to Ellis Carr, who reported to Tim Woods, a Finance Division Vice-President. This former employee has information concerning the fact that Freddie Mac's systems could not be adapted to handle the variety of lower quality loans the Company was purchasing, securitizing, and guaranteeing particularly during the 2006-2007 timeframe.

43. Another confidential witness worked as a Senior Business Analyst/Project Manager at the Company's Technology Office in Schaumberg, Illinois. She/he has information concerning the Company's failed effort to update its software programs used for tracking and accounting for the Company's Retained Portfolio. This former employee worked for the Company from late 2006 until mid-2008, when the Illinois office closed.

44. Another former employee worked as a Senior Financial Analyst in the Company's Single-Family Transaction Accounting Department, working with the Non-Performing Loan group. She/he was employed by the Company for a decade, until October 2008. She/he has information concerning monthly reports prepared by the Non-Performing Loan group, as well as the extreme growth of defaults the Company experienced. She/he also has information concerning the

Company's Touch More Loans initiative as well as the Company's insufficient "quality control" reviews of the non-traditional loans it acquired through that initiative.

45. Another confidential witness was a Senior Risk Analyst at the Freddie Mac headquarters in McLean, Virginia from late 2006 until April 2008. This former employee's work focused on loan loss reserve forecasting, and the loans underlying this analysis were all part of Freddie Mac's Single-Family Loan program. This former employee reported to Aurora Swanson ("Swanson"), the former Director of the Loan Loss Reserve Forecasting Unit. Swanson, in turn, reported to Tim Holloway ("Holloway"), the Senior Director of the Loan Loss Reserve Forecasting Unit, who reported to Sharathashandra Gobal ("Gobal"), the Senior Director with oversight of the entire unit. Gobal reported to the Vice President of the Credit Risk Department Devazyoti Ghosh ("Ghosh"), who was known by the nickname "Doc." Ghosh reported to Dr. Peter Federico ("Federico"), the Senior Vice President of Credit Risk, and he reported to Cook. Cook, who reported to Syron, was in charge of all Single-Family transactions, and she oversaw the work managed by Federico and Doc Ghosh. This former employee has knowledge concerning, among other things, Freddie Mac's Loan Loss Reserve Model and the Company's forecast of its Loan Loss Reserve requirements. She/he also performed quarterly credit loss analyses for Freddie Mac's Single-Family portfolio.

46. Another confidential witness worked for the Company for almost two decades until the first quarter of 2007. For the last six years of this former employee's tenure with the Company, she/he worked in Freddie Mac's Retained Portfolio Department as the Director of Mortgage Investor Relations. She/he was a portfolio manager doing "business development work with investors by marketing Freddie Mac products." Her/his group was managed by Mark Hansen, who reported to John Prince ("Prince"), the Vice President of Investment Relations. Prince reported to Cook, who

reported to Syron. This former employee's job was to engage in sales meetings with managers of pension funds and other institutional investors. She/he has knowledge concerning Freddie Mac's securitizations as well as its retained and guarantee fee portfolio, and the fact that the models the Company relied on contained insufficient data and were out-of-date.

47. Another confidential witness worked as a Senior Financial Analyst in Freddie Mac's Corporate Financial Reporting and Analysis Group at the Company's McLean, Virginia headquarters. She/he worked at this position from late 2006 until September 2008, and her/his work focused on the preparation of financial disclosures for inclusion in Freddie Mac's Annual Reports. These disclosures pertained to both of Freddie Mac's main business lines, the "Investment Management/Retained Portfolio" business (also called the loan business) and its "Mortgage Securitization/Guarantee" business (also called the securitization business). This former employee reported to Fifi Chang ("Chang"), a manager in the Corporate Financial Reporting and Analysis Department. Chang reported to Michael Beauch ("Beauch"), who was the Director in that department. Beauch reported to Robert Mailloux ("Mailloux"), the Vice President for Financial Reporting and Analysis. Mailloux reported to Jim Egan ("Egan"), who became the Corporate Controller when the former Controller, David Kellerman ("Kellerman") became the interim CFO in January 2009, after Piszel was fired in September 2008. The former Senior Financial Analyst said this reporting line was responsible for preparing the disclosures presented in all of the Notes to the Consolidated Financial Statements in the Company's Annual Reports. This former employee has knowledge concerning the Company's deficient disclosures about financial guarantees and transfers of securitized interests in mortgage-related assets.

48. One former employee worked for Freddie Mac as a Senior Transaction Manager from 1988 until September 2008. This former employee reported to Director Theresa Myers

("Myers"), who left the Company in December 2008. Myers reported to Director Lynn Sala ("Sala"), who reported to Vice President of Operations Mark Pettit ("Pettit"), who reported to Senior Vice President of Operations Joe Rossi ("Rossi"). She/he worked on flows transactions, which are deals by which Freddie Mac buys loans from originators. She/he has knowledge concerning the Company's diminishing quality control review of the loans it bought and how the Company did not force sellers to buy back bad loans, despite having the contractual right to do so. In addition, she/he also has knowledge concerning the credit enhancements (*i.e.*, mortgage insurance) the Company was supposed to have in place, and how those enhancements did not cover risky, low quality loans.

49. The confidential witnesses include a former Senior Financial Analyst for Freddie Mac who worked in Single Family Operations from late 2005 through December 2007. This former employee was responsible for control and documentation functions for Sarbanes-Oxley reporting within Single Family Operations. She/he has knowledge concerning the Company's non-performing loans, and that the Company created a new division in late 2007, called Loans in Acceleration, to deal with the ever-increasing volume of subprime and non-prime loans that were going bad.

50. Another confidential witness worked as a Business Analyst Consultant, and was employed by Actualized Consulting, which was hired to work on at least two projects for Freddie Mac during the Class Period. She/he was involved in a project to automate the Company's internal reporting on credit losses from non-performing loans, and worked on the project from August 30, 2008 until October 17, 2008.

51. One confidential witness worked as a Senior Quality Control Specialist with Clayton Group ("Clayton") in Tampa, Florida from November 2004 through June 2008. This former Clayton employee has a substantial amount of experience in the mortgage due diligence industry, and was responsible for auditing loans in various "pools of loans" being sold by a loan originator to

entities such as Freddie Mac. She/he has knowledge concerning, among other things, how the number of loans reviewed got smaller and smaller as the loan pools became larger.

52. Another confidential witness worked as a Director of Enterprise Risk Management at the Company from 2003 through 2008, and has information concerning Freddie Mac's loan loss reserves, as well as information she/he was told concerning how Syron overrode expectations for the Company's Home Price Appreciation modeling. She/he also recalled hearing information concerning Syron's overriding of loan loss reserve forecasts. This former employee also has information concerning the Company's knowledge that its models were wrong.

53. One confidential witness worked at Freddie Mac until early 2007 as a Servicing Manager for Non-Performing Loans. She/he was responsible for attempting to prevent loan losses, and has information concerning the Company's expectation that credit losses were going to increase because of the Company's exposure to subprime loans that were not being labeled as subprime. She/he knew the loans in the Non-Performing Loan group were low quality and posed high default risks to the Company. In addition, this former employee was aware of the fact that Freddie Mac's software systems were incapable of recognizing and handling the non-traditional loans the Company was buying, as well as the fact that Company Vice President Ingrid Beckles ("Beckles") knew of the Company's non-performing loan forecasts. She/he also has knowledge of the Company's failure to require lenders to repurchase loans that quickly became delinquent.

54. The confidential witnesses include a former Contracts Coordinator who worked for the Company until approximately January 2008, when it became clear the "ship was sinking." This former employee was responsible for reviewing contracts with lenders, and regularly interacted with members of the Company's sales and legal teams. She/he has knowledge concerning, among other things, the manner in which Freddie Mac acquired loans and the deviations from its underwriting

standards when making such acquisitions. She/he also stated that investment banks were selling "crap" to the Company through structured deals, and how those deals involved large amounts of risky subprime loans, as well as the fact that Freddie Mac hid the fact it was retaining subprime loans by using a non-standard definition of "subprime."

55. One confidential witness worked as a Financial Analysis Director for the Freddie Mac Retained Portfolio Group until mid-2006, and then as a Transaction Reporting Director until early 2007. In each position, her/his job involved reporting on loans purchased or owned by the Company. She/he helped prepare reports regarding the volume of loans coming in to the Company, and she/he has knowledge concerning the Company's CFO Briefing Deck document, which was circulated monthly and discussed at monthly executive level meetings. This former employee has knowledge that the Company's credit department knew of the poor quality loans in the Company's portfolio, but "was told not to say anything."

56. Another confidential witness worked as a former Senior Loan Analyst until March 2006, and has knowledge concerning internal pressure to get the Company into the non-prime and non-traditional loan market, wherein the Company deliberately sacrificed loan quality for loan quantity. She/he has knowledge concerning the loosening of the Company's underwriting standards and limited quality control review of risky loans. She/he also has knowledge of how the Company pre-established market share targets, and underwriting standards that were deliberately lowered to meet those targets, and also preset the maximum rejection rate it would allow its quality control team to have at 5% - even if the actual number was significantly higher than that.

57. One former employee worked as an Operational Risk Manager through May 2007, and has knowledge concerning the Company's Fraud Investigation Unit's inability to detect fraud, and how the Company was becoming more and more exposed to subprime loans.

58. Another confidential witness worked as a Financial Services Consultant with Primatics Financial ("Primatics") from July 2007 until March 2008. Primatics specializes in securities and loan accounting, and was engaged by Freddie Mac to participate in a subset of a project at Freddie Mac known as the "end-to-end" project, which was designed to map and identify weaknesses in the Company's internal controls. This former consultant interviewed approximately 200 to 300 Freddie Mac employees and created various narratives depicting the Company's financial reporting processes for amortization of securities. She/he has knowledge concerning the Company's internal systems and reporting process, and how inflated portfolio values allowed Freddie Mac to appear to be in a better capital position than it was.

59. Among the confidential witnesses is a former Senior Financial Analyst with Freddie Mac's Multi-Family Affordable Housing Group who worked with the Company until mid-2007. She/he was responsible for financial reporting for the Multi-Family Affordable Housing group, including reports used during quarterly board meetings and "dry-runs" for the board meetings. She/he worked closely with peers in the Single Family Affordable Housing team, and recalls seeing losses in the Single Family Affordable Housing report data resulting from Alt-A loans the Company purchased.

60. One confidential witness worked as a Project Management Organization Senior Business Analyst with the Company until mid-2008. This former employee was tasked with "impact assessments" regarding new products and new initiatives. She/he has knowledge concerning, among other things, the Company's focus on getting heavily involved in the subprime market in mid-2007.

61. Another confidential witness worked as a Senior Director of New Product Development in the Company's Single Family Operations until August 2006. She/he was responsible for developing guidelines for the Company's purchase of non-traditional loans from

Freddie Mac customers, and worked with non-traditional loan products such as interest-only and stated income/stated asset ("SISA") loans, as well as various types of adjustable rate mortgages ("ARMs"). She/he has knowledge that Freddie Mac began targeting the non-prime and non-traditional market because it was losing market share, and also knew that the Company's Loan Prospector software program, which was designed to score and determine which loans the Company should purchase, was not able to adequately analyze or assign risk to non-prime and non-traditional loans.

62. One confidential witness worked as the Product Controller for the Retained Portfolio from March 2006 through the end of January 2008, although her/his employment did not officially end until March 31, 2008. This former employee was a member of the Company's "Impairment Committee" that examined the Company's $150 billion of non-agency triple-AAA rated securities. She/he has knowledge concerning the small number of impairments that occurred at Freddie Mac, that its models were antiquated and not appropriate for the market in 2007 and 2008, and that the Company's risk exposure was, in reality, substantially larger than that of investment banks such as Goldman Sachs or JP Morgan.

63. As demonstrated below, the information provided by myriad confidential witnesses corroborated not only each other's accounts of Defendants' fraud, but also the documents and investigative materials discussed herein. Further, post-Class Period events, including Freddie Mac's most recent reported financials, corroborate the story behind Defendants' fraud detailed herein.

VI. CONTEXT OF DEFENDANTS' FALSE AND MISLEADING STATEMENTS

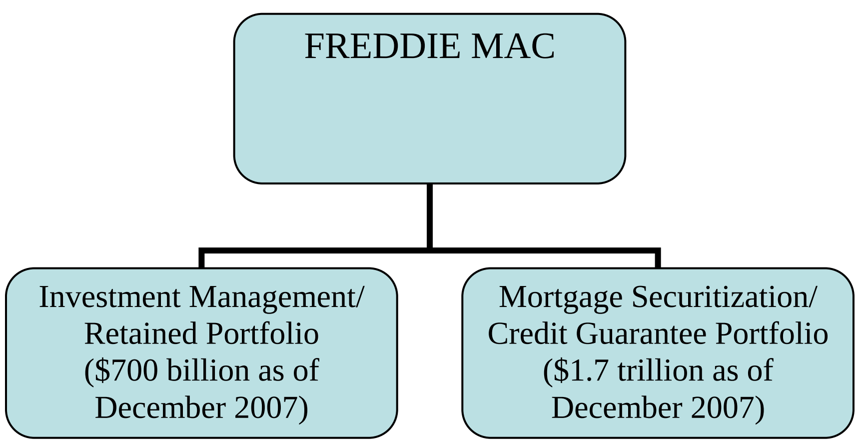
A. Background on the Company

64. Freddie Mac is a stockholder-owned company chartered by Congress in 1970 to stabilize the nation's residential mortgage markets and expand opportunities for homeownership and

affordable rental housing. Freddie Mac's mission is to provide liquidity, stability, and affordability to the United States housing market. This mission is fulfilled through purchasing residential mortgage loans and mortgage-related securities in the secondary mortgage market.

65. Freddie Mac generates income by purchasing mortgages, guaranteeing timely payment, and by holding mortgage loans and mortgage-related securities in its "Retained Portfolio" as an investment. As one the largest purchasers of mortgages, Freddie Mac's customers are predominately primary mortgage lenders. These lenders include mortgage banking companies, commercial banks, savings banks, community banks, credit unions, state and local housing finance agencies, and savings and loan associations.

66. There is a distinction at Freddie Mac between its two "channels of business." According to a former Company Vice President of Investor Relations who worked for Freddie Mac for 18 years until early 2007, the Mortgage Securitization/Credit Guarantee business was the "main channel" and the other channel was the Investment Management/Retained Portfolio business. The distinction between the two channels is demonstrated below:



1. Freddie Mac's Mortgage Securitization/Credit Guarantee Business

67. The Mortgage Securitization/Credit Guarantee channel handled Freddie Mac's purchases of whole loans from loan originators such as Countrywide, Washington Mutual, Wells

Fargo, and Wachovia.[7] A lender originating a mortgage can either hold the mortgage in its own portfolio, securitize the mortgage, or sell the mortgage to a secondary mortgage investor, such as Freddie Mac. Securitization, a form of structured finance, involves the pooling of financial assets, especially those for which there is no ready secondary market, such as mortgages, credit card receivables and student loans. These lenders, among others, sold "pools" of loans to Freddie Mac. Freddie Mac, as part of the secondary market, purchases a large number of mortgages, and bundles them together. The former Vice President of Investor Relations said these transactions are swaps in which Freddie Mac takes the mortgages in the pool from the originator and in return provides the originator with a security backed by the mortgage loans, which are called "Participation Certificates" or "PCs." Freddie Mac then sells the PCs to investors or holds them in their investment portfolio.

68. These swap transactions are subject to the Company's Seller-Servicer Guide, in which Freddie Mac sets forth the selling and servicing requirements, duties, and responsibilities for companies selling and/or servicing the loans Freddie Mac acquires. Freddie Mac then guarantees the PCs and the related MBS. In other words, the Company routinely assumes the risk that borrowers will default on their payment obligations – referred to as a "Freddie Mac Guarantee." In sum, Freddie Mac securitizes and guarantees timely repayment of principal and interest on pools of mortgage-related securities originated by the Company's customers.

69. The way these transactions work is that when homeowners pay their monthly mortgage, the lender sends the payments to Freddie Mac who deducts fees for guaranteeing timely payments before passing the remainder of the payment through to investors. Freddie Mac generates

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[7] Primary market lenders originate loans to homebuyers, who receive funds from the seller once the property is sold.

a monthly guarantee and management fee in addition to a one-time delivery fee based on the credit quality of the underlying loans for assuming the mortgage risk.

70. The former Vice President of Investor Relations stated that in this business line, the Company swapped its PCs in return for loan pools. Since the transactions were collateral-for-collateral swaps and involved no cash, Freddie Mac operated essentially as an insurance company that had "no balance sheet impact," *i.e.*, the Company's accounting for these transactions did not result in assets being recorded against the balance sheet. Freddie Mac's balance sheet would show as an asset the estimated present value of the stream of income flowing from the guarantee fees, and as a liability the estimated dollar amount of the risk incurred by Freddie Mac's guarantee the residential mortgage loan borrowers would perform. In the securitization process, Freddie Mac established so-called "Unit Investment Trusts," which took ownership of the mortgage loan collateral and issued the PCs. The PCs were sometimes referred to as shares in the securities issued by the Trusts, and also are sometimes called MBS, bonds, or notes. At the end of 2007, the Company's Guarantee Fee book of business amounted to $1.7 trillion.

2. Freddie Mac's Investment Management/Retained Portfolio Business

71. Additionally, Freddie Mac purchases mortgage and mortgage-related securities to hold in its "Retained Portfolio" for investment purposes. Freddie Mac finances these purchases with money borrowed directly from private investors in the form of "agency debt" and by entering into derivative contracts in the capital markets. Freddie Mac invests in mortgage-related securities or "MBS" issued by government agencies, referred to as agency securities. Freddie Mac also invests in "non-agency" MBS issued by Wall Street investment banks. Thus, among other things, the Retained Portfolio purchased and held MBS issued by Wall Street firms. The Company's Retained Portfolio

amounted to about $800 billion in December 2008, so it was roughly half the size of the Guarantee Fee book of business.

B. Non-Traditional and Non-Prime Mortgages Fueled the Crest and Crash of the United States Housing Market

72. For a number of years prior to 2006, low interest rates and large inflows of foreign funds created easy credit conditions, fueling a housing market boom and encouraging debt-financed consumption.[8] In the years before the housing crisis, the behavior of lenders changed dramatically. Lenders offered more and more loans to higher-risk borrowers.[9] A study by the Federal Reserve found the average difference between subprime and prime mortgage interest rates – often dubbed the "subprime markup" – declined from 280 basis points in 2001, to 130 basis points in 2007. In other words, the risk premium required by lenders to offer a subprime loan declined. This occurred even though the credit ratings of subprime borrowers, and the characteristics of subprime loans, both declined during the 2001–2006 period, which should have had the opposite effect. In other words, the credit risk (*i.e.,* risk of default) was high even though the price was low.

73. In addition to considering higher-risk borrowers, lenders offered increasingly risky loan options and borrowing incentives.[10] One high-risk option was the "No Income, No Assets"

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[8] The U.S. home ownership rate increased from 64% in 1994 (about where it had been since 1980) to an all-time high of 69.2% in 2004. Between 1997 and 2006, the price of the typical American house increased by 124%. During the two decades ending in 2001, the national median home price ranged from 2.9 to 3.1 times median household income. This ratio rose to 4.0 in 2004, and 4.6 in 2006. U.S. household debt as a percentage of annual disposable personal income was 127% at the end of 2007, versus 77% in 1990.

[9] Subprime mortgages amounted to $35 billion (5% of total originations) in 1994, $160 billion (13%) in 1999, and $600 billion (20%) in 2006.

[10] By 2005, the median down payment for first-time home buyers was 2%, with 43% of those buyers making no down payment at all.

("NINA") loan, where the prospective borrower was not required to provide income or asset verification. Another creation was the interest-only adjustable-rate mortgage ("IO ARM"), which allowed the homeowner to pay just the interest (not principal) during an initial period of the mortgage.[11] Still another new exotic mortgage option was a "payment option" loan, in which the homeowner could pay a variable amount, but any interest not paid was added to the principal. Mortgage underwriting standards also declined precipitously during the boom period. The use of automated loan approvals allowed loans to be made without appropriate review and documentation.

74. The credit and house price explosion led to a building boom and eventually to a surplus of unsold homes, which caused U.S. housing prices to peak and begin declining in mid-2006. The housing market began to unravel in late 2006 when many homeowners, who had over-extended themselves by taking out mortgages featuring exotic terms, such as artificially low payments for introductory periods, began to default. So too did homeowners with unstable and/or unverified incomes. Dramatic increases in defaults had a cascading effect on credit markets due to the correlation between rising rates of default on non-prime and non-traditional mortgages and the falling values of the encumbered houses, on the one hand, and the decline in the value of securities backed by those mortgages, on the other.

75. One catalyst for the non-prime and non-traditional housing market boom was the widespread use and creation of MBS by a host of companies, ranging from Wall Street investment banks to Freddie Mac. The pooled assets are transferred to a special purpose entity and serve as collateral for new financial assets issued by the entity. Back in the early 2000s, as lenders reached out to increasingly risky borrowers with increasingly risky mortgage products, the pool of highly

[11] The proportion of subprime ARM loans made to people with credit scores high enough to qualify for conventional mortgages with better terms increased from 41% in 2000 to 61% by 2006.

risky non-prime and non-traditional loans continued to expand. At that time, investment bankers sought to find ways to capitalize on the phenomenon, and earn the lucrative fees that these loans offered. To do so, they turned to securitization.

76. Securitization, combined with investor appetite for the securitized assets, and the high credit ratings formerly granted to MBS and other "fixed-income" products by rating agencies, meant mortgages with a high risk of default could easily be sold to third parties – with the risk shifted from the mortgage originator to investors. Though Defendants failed to adequately disclose it during the Class Period, Freddie Mac was more than happy to take on this risk.

C. Prior to the Start of the Class Period, Defendants Were Fully Aware of the Immense Risks Associated with the Non-Prime and Non-Traditional Mortgage Market

1. Syron is Hired to "Strengthen" the Company

77. Syron took the helm at Freddie Mac in 2003, following revelations of accounting irregularities wherein the Company had understated earnings by about $5 billion in an apparent attempt to smooth out volatility in its profit statements. To settle charges of accounting fraud stemming from these irregularities, Freddie Mac was required to pay $125 million in penalties to OFHEO.

78. Syron was tasked with cleaning up the Company's financial accounting and strengthening the foundation of Freddie Mac. As a GSE responsible for maintaining liquidity in the U.S. housing market, Freddie Mac enjoyed a special mandate and position of public trust. This implicit government backing was important because it provided Freddie Mac the ability to borrow money at lower rates than the Company's competitors, and, at the same time, seek to maximize its revenues and returns.

79. Freddie Mac had traditionally backed only the "plain vanilla'" end of the mortgage market, concentrating on conventional 30-year fixed rate loans to prime borrowers, which carried low volatility and risk of default.

80. By 2004-2005, the conventional mortgage market had matured and private lenders were rapidly expanding into ever-riskier non-prime and non-traditional loans. As the exotic loan mortgage market exploded in the middle of the decade, Defendants found themselves losing market share to the more aggressive private lenders who were originating riskier and riskier exotic mortgages to borrowers with below prime credit.

2. Freddie Mac's Employees Sound the Alarm

81. Given the Company's GSE status, Freddie Mac was a uniquely large and protected player in the mortgage market, and thus could set standards and influence pricing in ways other lenders could not. Because Freddie Mac's protected status as a GSE allowed it to raise money more cheaply than the Company's competitors, Freddie Mac had the capability to quickly gain market share and expand into the non-prime and non-traditional mortgage market by out-pricing the Company's competitors.

82. Looking for opportunities to grow beyond the Company's traditional prime, fixed-rate conventional business, Defendants – who were heavily incentivized by their compensation structure to chase short-term profits – made a fateful decision to expand into the extremely risky exotic mortgage market and play "catch-up" with the most aggressive of private lenders. Defendants consciously undertook the acquisition of these risky loans and securities backed by them despite adamant opposition from many of the Company's own risk managers, and despite the fact that a similar prior venture into non-prime and non-traditional loans was abandoned back in 1990 because it was a complete financial failure.

83. Indeed, throughout 2004, Freddie Mac's Chief Risk Officer, Andrukonis, sent numerous memos and e-mails to Syron urging Freddie Mac to stop purchasing loans with no income or asset requirements (the so called SISA or NINA loans) ***"as soon as practicable."*** On April 1, 2004, Andrukonis sent correspondence to Tracey Mooney, then Vice President of Single Family Credit Management at Freddie Mac, indicating ***"while you, Don [Bisenius] and I will make the case for sound credit, it's not the theme coming from the top of the company and inevitably people down the line play follow the leader."***

84. Also on April 1, 2004, Bisenius, then senior vice president for Credit Policy and Portfolio Management at Freddie Mac, sent correspondence to then senior vice president of Mortgage, Operations & Funding Mike May ("May"), noting ***"we did no-doc lending before, took inordinate losses and generated significant fraud cases. I'm not sure what makes us think we're so much smarter this time around."***

85. On April 5, 2004, Andrukonis sent an e-mail to then Chief Operating Officer Paul Peterson regarding the NINA loans Freddie Mac had begun to purchase indicating ***"[i]n 1990 we called this product 'dangerous' and eliminated it from the marketplace."***

86. An internal Freddie Mac e-mail of September 4, 2004 indicated ***"Freddie Mac should withdraw from the NINA market as soon as practical. [Performance is poor as evidenced by] first year delinquency rates on these mortgages, which range from 8 to 13%, depending on the lender."*** On September 7, 2004, Freddie Mac employee Donna Cogswell sent correspondence to Syron, May, and others indicating that Freddie Mac was effectively ***"mak[ing] a market"*** in NINA loans. Also on September 7, 2004, Syron and others received an e-mail arguing that "[***t]he potential for the perception and reality of predatory lending with this product [NINA] is great,"*** which also warned that mortgage lenders were targeting ***"borrowers who would have trouble qualifying for a***

mortgage if the financial position were adequately disclosed." A true and correct copy of the September 7, 2004 e-mail exchange, made public by the U.S. House of Representatives on December 9, 2008, is attached hereto as Exhibit "A."

87. On September 8, 2004, Andrukonis sent correspondence to May expressing his displeasure with management's decisions regarding risk management:

> ***At last week's risk management meeting I mentioned that I had reached my own conclusion on this product from a reputation risk perspective. I said that I thought you and or Bob Tsien had the responsibility to bring the business recommendation to Dick [Syron], who was going to make the decision. Marty and Patti [Cook] asked me what it meant that I opposed this product. I said that my job was to speak out to Dick and then to the Board if I thought we were in the wrong place on business or reputation risk. I think of this letter as comparable to the one Don B sent Paul. What I want Dick to know is that he can approve of us doing these loans, but it will be against my recommendation. I wouldn't be surprised if he disagrees with my conclusion.***

A true and correct copy of Andrukonis' September 8, 2004 e-mail, made public by the U.S. House of Representatives on December 9, 2008, is attached hereto as Exhibit "B."

88. Defendants did not accept Andrukonis' and the other risk managers' recommendations. ***Instead, Freddie Mac fired Andrukonis***. Arnold Kling, a former senior economist at Freddie Mac from 1986 to 1994, testified before Congress after the close of the Class Period that ***"[w]hen, as at Freddie Mac, the chief risk officer warns you that your mortgage policies are ill-advised, I can think of more appropriate responses than firing the chief risk officer."***

89. A former Director of Operational Risk Management, who worked at Freddie Mac until October 2008, stated that when Andrukonis was fired for speaking out against Syron, it created and indoctrinated a culture at the Company where employees dared not dissent from upper-echelon management because they feared losing their jobs.

90. The former Vice President of Investor Relations stated Freddie Mac's top management, specifically Syron, Piszel, and Cook, had knowledge the Company's purchase of private-label MBS collateralized by subprime mortgage loans created a significant, material exposure to risk. She/he recalled an internal debate during 2004 (which has subsequently been detailed in media reports) concerning the Company's "creep" towards less-than-prime residential mortgage loans. She/he knew Andrukonis argued strenuously to Syron against buying non-prime mortgages for the Company's Retained Portfolio and Andrukonis left the Company in the wake of this dispute. She/he stated Syron, Piszel, and Cook, as well as former President and COO Gerald McQuade ("McQuade"), made the decisions about entering into subprime transactions and the Company's disclosure thereof.

91. The former Vice President of Investor Relations emphasized that "unequivocally, yes, Syron, Piszel, Cook, and McQuade had the information about the risk exposure and made the decisions" about the purchases of private label MBS collateralized by subprime mortgages. Rather than heeding the Company's own internal risk warnings, they chose to follow the lead from Wall Street to ignore known risk exposure in favor of short-term profits and market share. As background to this fiasco, the former Vice President of Investor Relations stated that in the summer of 2003, in response to Freddie Mac's accounting scandal and restatement, Syron, Piszel, and Cook were brought in as new top management, but they were "outsiders" to the mortgage business. Thus, they refused to heed Andrukonis' directive to avoid the non-prime and non-traditional arena. She/he stated top management saw non-traditional and subprime loans as a "critical driver of earnings," and there was "pressure to remain relevant" – in other words, Syron, Piszel, and Cook were after market share, not mortgage quality.

92. Freddie Mac was also warned once in 2003 and again in 2006 by the Company's regulator about the dangers it might pose to the entire financial sector in terms of systemic risk. In a prescient analysis released in 2003, OFHEO outlined the factors most relevant to analyzing the impact of Fannie Mae and Freddie Mac on systemic risk:

(a) High levels of interdependencies among financial institutions;

(b) High leverage of such institutions;

(c) The presence of bubbles in the prices of real and financial assets;

(d) Under pricing of the financial safety net;

(e) Weak market discipline of institutions covered by the safety net;

(f) Lax safety and soundness regulation and poor public disclosure; and

(g) The presence of macroeconomic problems.

93. Defendants not only ignored these warnings, they went further – taking the unprecedented step of abandoning the Company's underwriting principles and eventually allowing the Company to operate at a 55:1 leverage ratio based on core capital, much higher than that of the recently bankrupted Lehman Brothers.

3. Defendants Ignore Repeated Warnings and Knowingly Plunge Into the Deep End of the Non-Traditional and Non-Prime Mortgage Market

94. In 2004 – following the accounting scandal at Freddie Mac (as well as a similar scandal at Fannie Mae) – the junk loan share of all mortgages in the United States began to rise, going from 8% in 2003 to about 18% in 2004, and peaking at about 22% in the third quarter of 2006. During this time, Freddie Mac's purchases of exotic mortgages and MBS exploded.

95. Although a large share of the subprime loans that caused the crisis in the international financial markets were so-called private label securities – issued by banks and securitizers other than Freddie Mac – Freddie Mac became one of the biggest buyers of the AAA

tranches of these subprime pools in 2005-2007. According to a September 14, 2008 *New York Times* article entitled "The Joys of Ownership," Freddie Mac and Fannie Mae bought almost $170 billion in subprime MBS in 2005 – ***roughly one-third of the total issuance that year***. The GSEs bought an additional $120 billion in subprime MBS in 2006 – ***roughly 27 percent of the total amount issued***.[12] The GSEs bought an additional $62 billion in subprime MBS in 2007 – ***roughly 35% of the total amount issued***. Over the period 2002-2007, ***the GSEs bought an astounding 34% of the total amount of subprime MBS issuance***. Freddie Mac was a much more prodigious purchaser of subprime MBS than Fannie Mae. For example, during the 2006-2007 period, Freddie Mac accounted for 70% – or $120 billion – of the GSEs' subprime MBS purchases. *See* OFHEO's Mortgage Markets & the Enterprises in 2007 at 27. A true and correct copy of OFHEO's report is available at http://www.fhfa.gov/webfiles/1164/MME2007revised.pdf.

96. Unfortunately for the Company's shareholders, virtually all of the single family private MBS Freddie Mac purchased during this time were not backed by investment grade loans: they were backed by Alt-A, subprime, and other default prone non-prime or non-traditional loans. During the 2006-2007 period, 100% of such purchases consisted of these non-prime or non-traditional loans. The former Vice President of Investor Relations stated that because of the riskiness of the loan collateral, Freddie Mac encountered great vulnerability from risky loans. She/he said loan originators would sell their risky subprime and non-traditional loans to Wall Street firms. The Wall Street firms would securitize those loans and issue securities in tranches. Freddie Mac then purchased and retained significant amounts of such securities in its Retained Portfolio.

[12] In 2003-2004 time period, Freddie Mac purchased 49% of all subprime private MBS issuance.

97. A post-Class Period September 28, 2008 *Bloomberg* article entitled, "Fannie Mae, Freddie Mac Subprime Spree May Add to Bailout" began:

> ***Freddie Mac Chief Executive Officer Richard Syron stood before investors at New York's Palace Hotel in May last year lauding his company's "cautious" avoidance of the subprime-mortgage crisis.***
>
> ***<u>What Syron, who was ousted last week, didn't say was that Freddie Mac had been gorging on subprime and Alt-A debt.</u> While it and the larger Fannie Mae bought the safest classes of the mortgage-loan pools, Freddie's purchases totaled $158 billion, or 13 percent, of all the securities created in 2006 and 2007, according to data from its regulator and Inside MBS & ABS, a Bethesda, Maryland-based newsletter used by Federal Reserve researchers.***

* * *

98. The above-quoted article corroborates the statements of many confidential witnesses described herein. Indeed, the former Vice President of Investor Relations stated that on an industry-wide basis, marked changes took place in the mix and performance of residential mortgage loans originated during the 2001-2008 timeframe. For the market as a whole, the market share accounted for by subprime and Alt-A loans quintupled between 2001 and 2006 and then declined sharply thereafter. The more recent subprime and Alt-A loan originations are performing far worse than earlier originations. For example, subprime ARM defaults are 21 times those of prime fixed-rate mortgages.

99. In general terms, this former Vice President of Investor Relations stated the Company began acquiring high-risk (*e.g.*, non-prime and non-traditional) loans as early as 2003-2004, and particularly in the 2006-2007 time frame when major loan originators threatened to take their business to Freddie Mac's competitors, including Fannie Mae. The former Vice President of Investor Relations stated that on an aggregate basis, Freddie Mac's Guarantee Fee book of business grew in each of the past six years during 2003-2008. The total amount of PCs and Structured Securities issued as of year-end 2008 amounted to nearly $1.9 trillion.

100. The former Vice President of Investor Relations stated that, in the 2003-2004 timeframe, interest rates were too low for Freddie Mac to maintain profits on traditional fixed income investments, such as investment quality mortgage loans. As such, the Company moved into the subprime arena to achieve more profits and market share. The Company shifted its emphasis and increased its asset allocation to non-prime mortgages to find a greater "spread" than was available with prime mortgages.

101. As has now been widely publicized, the former Vice President of Investor Relations confirmed Andrukonis argued strenuously to Syron against buying subprime mortgages in the Company's swap deals (*i.e.,* Guarantee Fee Deals) or for its Retained Portfolio. The former Vice President of Investor Relations had personal knowledge of the dispute, and recalled Andrukonis was a very principled man who lost his job over the dispute.

102. Rather than listening to its Chief Risk Officer and the Company's regulator, Freddie Mac chose to rely on non-prime and non-traditional mortgages and continued to do so even into 2007. As many homeowners were repaying those loans early through refinancing, Freddie Mac could not afford to lose the business. There were major increases in the Company's annual issuance of MBS based on subprime and Alt-A mortgage loan collateral between 2003 and 2006.

103. A former Financial Services Consultant stated that from mid-2007 through March 2008, as understood from speaking with a significant number of Freddie Mac personnel at the time, the Company and its executives believed the abundance of subprime loans in the market in this timeframe presented a significant opportunity for the Company to "create more expansive product lines" and buy more loans. In other words, the Company saw the glut of junk loans in the marketplace as a buying opportunity – even after the bottom had fallen out of the subprime market.

This former Financial Services Consultant stated Freddie Mac was more willing to take risks with the purchase of loans during this time frame than Fannie Mae.

104. According to a former Senior Business Analyst in the Company's Project Management Organization group tasked with "impact assessments" regarding new products and new initiatives, in approximately mid-2007 there was a reorganization that put Senior Vice President of Credit Risk and Policy Bisenius in charge of an initiative related to subprime mortgages. This initiative included a "big push" regarding expanded involvement in subprime mortgages beginning in mid-2007.

105. Similarly, a former Senior Financial Analyst stated the Company launched its "Touch More Loans" program sometime in late 2006 or early 2007 in an effort to compete with Fannie Mae. This initiative involved buying more non-traditional loans, and employees learned about it during a "big meeting" held by Company managers and/or executives. She/he recalled the Company was aggressively promoting the initiative internally, sending emails and handing out stickers. This former Senior Financial Analyst said she/he and other employees were "concerned" about the initiative because the program was "risky." Indeed, she/he learned a new "quality control" group had been set up in conjunction with Touch More Loans, but that group had only 30 days to raise concerns and/or return or swap the loans it purchased. Despite this mandate, the Company was purchasing too many loans to adequately perform quality control within that short timeframe.

106. A former Director of Mortgage Investor Relations stated the Touch More Loans initiative developed in the context of a bidding war over market share between Fannie Mae and Freddie Mac, and also between the two GSEs and private-label securitizations offered by Wall Street Firms. She/he said the securitizations underlying the Touch More Loans initiative generally had as their collateral subprime and Alt-A loans, and that Freddie Mac purchased these securitizations and

held them in its Retained Portfolio. This former employee said during 2005 and 2006, approximately 50% of Freddie Mac's purchases were subprime, Alt-A, and other non-prime loans, both for its Retained Portfolio business and its Guarantee Fee business. Publicly available information has now made it clear this trend continued in 2007, when this percentage increased to approximately 53% of its purchases.

107. A former Director of New Product Development for the Company stated Freddie Mac began purchasing more subprime and Alt-A loans in approximately 2005 because it was losing market share. She/he said that in addition to buying interest only, SISA, and ARM loans, Freddie Mac also began buying more esoteric products, such as option-ARMs. This former Director of New Product Development stated Freddie Mac purchased most of its non-traditional products from big lenders. She/he stated she/he disagreed with those who say the Company had no way of knowing what it was getting into when it purchased non-traditional loans. She/he said a lot of people within Freddie Mac were "very uncomfortable" with the increasing popularity of non-prime and non-traditional loans.

108. A former Senior Transaction Manager who previously worked as a fraud investigator at Freddie Mac in 1989 recalled Freddie Mac's initial venture into "no doc" loans made a "mess." She/he knows this because she/he spent a lot of time trying to clean up that mess. She/he stated the loans were dangerous, and created problems for Freddie Mac in the late 1980's, but that memories apparently were short at Freddie Mac. Indeed, this former employee with 20 years experience stated Cook told Company employees that Freddie Mac "got into this mess to retain market share and stay relevant." She/he also recalled that Syron always said you "shouldn't be proud to be number two in a duopoly." In other words, Syron wanted Freddie Mac to increase its market share vis-à-vis Fannie Mae – at any cost.

109. Freddie Mac sometimes purchased loans in Bulk transactions, which consisted of a large group of loans already issued to borrowers, often more than a year before the bulk sale to Freddie Mac, and typically ranged from $10 million to $1 billion. A former Senior Transaction Manager recalled handling two to three $500 million purchases by Freddie Mac per month.

110. The first step for a Bulk transaction was when a customer would alert Freddie Mac that it had a package of loans up for bid. The seller would then send Freddie Mac a "tape" with all the loan data on it. Typically, Freddie Mac and Fannie Mae were bidding against each other for the Bulk deals. The Freddie Mac Portfolio Analysis Group would be the first at the Company to analyze the tape. The Portfolio Analysis Group would provide statistics as to what percentage of loans fell into various "buckets." There were buckets breaking out how many loans fell into various risk parameter ranges, including credit score ranges, loan-to value ("LTV") ranges, geographic areas, property type, and whether the loan was a refinance or a purchase. Another risk parameter was whether there were delinquencies in the portfolio, and if so, how many delinquencies for each such loan. The former Senior Transaction Manager with 20 years experience recalled that historically, Freddie Mac did not purchase loans if the borrower had a 30-day delinquency within the preceding 12 months. Over the last few years, however, Freddie Mac increasingly bought these loans.

111. The Portfolio Analysis Group also stripped out loans Freddie Mac could not buy, such as loans with unusual interest rate schedules that could not be processed by the Company's software programs. The former Senior Transaction Manager recalled every type of loan had a program or product number assigned to it, and if a loan on a tape could not match up with a Freddie Mac product or program number, then it was supposed to be excluded. She/he stated the Portfolio Analysis Group used Portfolio Stratification software to "unpack the tape" and create reports of what buckets the loans fell into.

112. Although some of the loans purchased through the Bulk channel were seasoned (held for more than a year before sale to Freddie Mac), according to the Senior Transaction Manager with 20 years experience, the Bulk channel "was the only path for Alt-A loans, so Freddie Mac bought a lot more current production, which was not seasoned." She/he stated that in order to maintain and grow market share, Freddie Mac bought non-seasoned Alt-A loans because there were not enough seasoned Alt-A loans available. As justification for buying unseasoned, risky loans, the Company's Transaction Executives claimed they could "price" for the increased risk.

113. To that end, the former Senior Transaction Manager stated there was often a short turnaround from receipt of the tape to when Freddie Mac had to issue a bid on a Bulk transaction. With such short turnarounds (a week from receipt of the tape), the transactions were inherently riskier because there was not time to catch everything. "Once the money goes out, it's too late." She/he recalled there was a lot of pressure from the Company's sales department representatives and the transaction executive to get deals processed within the seller's time line.

114. This pressure to get the deals through led to errors. She/he recalled Director Theresa Myers got tired of fighting and gradually started pushing deals through to meet the transaction executives and sales department representatives' goals, even if the transaction managers believed it did not leave enough time to take all the steps necessary to process the transaction. She/he stated everyone had to rush to get large deals done without taking a good look at the data and that the sellers for these deals included Lehman Brothers, Merrill Lynch, Morgan Stanley, Bank of America, Citi, Washington Mutual, and Wachovia. For example, she/he recalled Lehman Brothers had a "deal" with Freddie Mac requiring a two-day turnaround time. Morgan Stanley usually required bids within four to five days of supplying a tape with loan information for thousands of

loans and that the transactions were typically in the $100 to $300 million range, but sometimes as much as $500 million.

115. The former Director of New Product Development recalled the Company's Expanding Mortgage Conduit Program was introduced in 2005, and was given the internal code name of "XMC." The XMC program was part of the Company's strategy to expand into "riskier products," such as subprime and Alt-A loans. She/he stated Syron had "regular communication" with employees via email in which he promoted XMC as a way for Freddie Mac to break away from its more "stodgy" image and be "reborn." This former employee also recalled the Touch More Loans program was based on the underlying philosophy that the market was changing and Freddie Mac had to change with it, *i.e.*, expose itself to risky subprime and Alt-A loans. She/he said the program meant Freddie Mac should try to deal with as many lenders as possible by "barely touching the loan before doing something with it," whether that meant holding the loan in its Retained Portfolio or securitizing and selling the loan in the secondary market.

116. A former Senior Business Application Project Manager knew from reading a variety of reports that during the 2006-2007 timeframe, that the loans Freddie Mac was buying were very risky when viewed from the perspective of the loan products themselves or the guidelines for underwriting them. She/he knew it was "highly questionable" whether the borrowers could pay back the loans because they were tailored for borrowers with limited ability to repay, and included adjustable rates with initial teaser rates, interest-only payments, as well as negative amortization loans. In addition, the underwriting guidelines were "loose" at best, because they did not require verification of income or assets. She/he said if Syron did not know about this, his lack of knowledge was at least reckless.

117. The former Vice President of Investor Relations stated that, during the 2006-2007 time period, as Freddie Mac moved toward the use of low quality loans as collateral, large loan originators such as Countrywide and Washington Mutual gave Freddie Mac the ultimatum of having to take loans of non-prime quality or risk losing deals. During 2006-2007, large loan originators would offer negotiated contracts with "lightly" documented and subprime loans. The originators told Freddie Mac that if the Company did not want the deals, they would be given to Fannie Mae. Freddie Mac relented in order to keep up with Fannie Mae and not lose potential business.

118. The former Vice President of Investor Relations said the Retained Portfolio fell into trouble and "ended up in the same boat as companies such as Bear Stearns and Lehman Brothers." She/he said although Freddie Mac's stated policy was to purchase only the most protected tranches of MBS, which were AAA rated private label MBS issued by non-governmental entities such as Wall Street firms, the underlying collateral presented risks requiring management. She/he said "bad loans are bad loans" and that Freddie Mac's Retained Portfolio suffered from the "toxic" loans it was knowingly relying on.

119. According to a former Senior Loan Analyst that worked in the Audit Operations area of the Company from late 1994 through March 2006, Freddie Mac regularly purchased loans where there was also a secondary loan on the property and the total of the two loans exceeded 80% of the total value of the home. This was known as piggybacking. "Freddie Mac was constantly doing loans with borrowers with no equity because of piggybacks. We constantly discussed it, that people have no reason to stay in their homes. They bought with no money down and bad credit to start with."

120. The former Senior Loan Analyst said the buyers really did not risk anything if they could not afford to keep the house and that "every one of those loans should never have been made."

She/he recalled most of the subprime loans she/he reviewed were piggyback loans and that it was "definitely more than half and could have been higher." She/he also stated that loans were being made to people with no income and no asset information, or people with 600 or 680 Fair Isaac Credit Organization ("FICO") scores. The former employee stated "Wall Street firms were pushing the limits" and Freddie Mac followed – it "turned a blind eye to get volume."

121. A former Senior Transaction Manager recalled that although Freddie Mac asked lenders to disclose the presence of second, or piggyback, mortgages, for loans sold to the Company, Freddie Mac often did not get that information. She/he stated the existence of the second loan was often not communicated to Freddie Mac. Although this former employee with 20 years experience pushed to get more data from lenders, "very few at Freddie Mac shared those concerns" and "no one wanted to upset the seller or risk not being able to buy enough loans to maintain market share." In other words, quality took flight to preserve quantity.

122. For example, the former Senior Transaction Manager recalled recently having lunch (after the Senior Transaction Manager left the Company) with a Freddie Mac Credit Manager who told her/him about deals the Credit Manager was forced to approve by her/his superiors. The Credit Manager would complain to the Director and Vice President about the risk in the loans she/he was being asked to approve, but her/his superiors would brush them off, and simply say they could "price for it." The total pricing Freddie Mac could impose, however, was inadequate to cover the expected risks.

123. The accounts of the confidential witnesses identified above have been corroborated by numerous post-Class Period events. For example, in congressional testimony on September 23, 2008, James Lockhart ("Lockhart"), the director of Freddie Mac's new regulator, the Federal

Housing Finance Agency ("FHFA"), cited these non-prime and non-traditional loans as the source of Freddie Mac's ultimate collapse, as reported in the *Washington Post*:

> ***Fannie Mae and Freddie Mac purchased and guaranteed "many more low-documentation, low-verification and non-standard" mortgages in 2006 and 2007 "than they had in the past." He said the companies increased their exposure to risks in 2006 and 2007 despite the regulator's warnings.***
>
> ***Roughly 33 percent of the companies' business involved buying or guaranteeing these risky mortgages, compared with 14 percent in 2005. Those bad debts on mortgages led to billions of dollars in losses at the firms.***

* * *

124. A December 10, 2008 *New York Times* article entitled "Ex-Officer Faults Mortgage Giants for 'Orgy' of Nonprime Loans," noted:

> ***Fannie Mae and Freddie Mac engaged in "an orgy of junk mortgage development" that turned the two mortgage-finance giants into vast repositories of subprime and similarly risky loans, a former Fannie executive testified on Tuesday.***
>
> ***The mortgage development, which began in 2005 and lasted until at least last year, happened as senior executives at the two government-sponsored enterprises ignored repeated warnings from internal risk officers that they were delving too deeply into dangerous territory, according to internal documents released at a Congressional hearing in Washington. The two companies have been taken over by the government.***

* * *

125. Without Freddie Mac's commitment to purchase non-prime and non-traditional loans and the AAA tranches of their securitizations, it is unlikely that the pools could have been formed and marketed around the world. Accordingly, not only did the Defendants destroy the Company's own financial condition and eviscerate billions of dollars of shareholders' money with their excessive purchases of subprime loans and other exotic loans in the three-year period from 2005 to 2007, but they also played a major role in weakening or destroying the solvency and stability of other financial institutions and investors in the United States and abroad.

4. The Individual Defendants Made Millions of Dollars Off of the Company's Expansion into Non-Prime and Non-Traditional Mortgages

126. Economists use the term "high-powered incentive contracts" to describe executive compensation packages where significant aspects of an executive's annual pay and personal wealth are tied to changes in the company's stock price or related performance measures such as earnings per share. Conversely, executive compensation packages that are largely insensitive to changes in the company's stock price or other performance measures are termed "low-powered incentive contracts."

127. Prior to and during the Class Period, the executive compensation plan at Freddie Mac was composed of a large stock and earnings-based component – compensating the Company's top executives with notably high-powered incentives. Unfortunately for Plaintiffs and Class members, Freddie Mac's executive compensation plan gave the Individual Defendants incentive to grab short-term profits and market share at the cost of the Company's and shareholders' long-term interests.

128. Taking risks with the non-prime and non-traditional mortgage market (with its now infamously dire consequences) proved tremendously lucrative for the Individual Defendants, who earned more than $80 million in total compensation between 2003 and 2008, as set forth in the chart below:

Name and Principal Position	Year	Salary	Bonus	Stock Awards	Option Awards	All Other Compensation[13]	Total ($)
Richard F.	2003	4,231	0	8,809,819	0	229,169	**9,043,219**

[13] Freddie Mac reports its executive compensation differently in annual proxy statements. From 2003-2005, it separated the categories "Other Annual Compensation" and "All Other Compensation." In 2006-2008, they were combined. This chart reflects the combined approach to reporting all other compensation used most recently by Freddie Mac in their proxy statements.

Syron							
	2004	1,100,000	2,500,000	4,826,707	166,580	452,015	**9,045,302**
	2005	1,100,000	2,200,000	4,821,289	165,390	298,222	**8,584,901**
	2006[14]	1,100,000	2,400,000	7,162,448	3,261,460	453,882	**14,377,790**
	2007	1,200,000	3,450,000	8,662,876	3,471,051	771,585	**17,555,512**
	2008	1,300,000					
Anthony S. Piszel	2003	n/a	n/a	n/a	n/a	n/a	**n/a**
	2004	n/a	n/a	n/a	n/a	n/a	**n/a**
	2005	n/a	n/a	n/a	n/a	n/a	**n/a**
	2006	88,750	3,100,000	93,593	0	123,062	**3,405,405**
	2007	650,000	1,350,000	1,875,521	0	302,578	**4,178,099**
	2008	750,000					
Patricia L. Cook	2003	n/a	n/a	n/a	n/a	n/a	**n/a**
	2004	250,000	3,000,000	1,873,771	18,580	124,433	**5,266,784**
	2005	600,000	2,750,000	1,095,889	37,590	20,462	**4,503,941**
	2006	600,000	2,300,000	1,118,767	533,747	367,954	**4,920,468**
	2007	600,000	1,400,000	1,717,224	603,851	302,469	**4,623,544**
	2008	650,000					

129. Freddie Mac's executive compensation policy of "pay for performance" was demonstrated throughout the Class Period in the Company's proxy statements. The compensation criteria evidences a financial incentive on the part of the Individual Defendants to purchase risky mortgages including Alt-A, subprime and other non-prime and non-traditional loans to the detriment of the Company's financial stability and value to shareholders.

130. In 2005, the Company described its "Short-Term Incentive Compensation" for the previous year as a program that "seeks to motivate executives, including the Chief Executive Officer, to work effectively to achieve our annual corporate performance objectives and to reward them when those objectives are met or exceeded." According to public filings, Freddie Mac's executives were compensated during their tenure for focusing on "improving market share and developing new capabilities to further penetrate the mortgage market."

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[14] In 2006, Freddie Mac began listing "Change in Pension Value and Nonqualified Deferred Compensation Earnings" in their Summary Compensation Tables. These values are omitted from this table.

131. Freddie Mac's criteria for annual bonuses in 2006 included objectives "of specific U.S. Department of Housing and Urban Development goals and sub-goals for the percentage of mortgages purchased by Freddie Mac that fall into the categories of low/moderate income, underserved areas, and special affordable housing." Yet, rather than purchasing prime loans that fulfilled the Company's affordable housing goals, Defendants established "Touch More Loans" – as described more fully above – as a way to ramp up the Company's purchase of non-prime and non-traditional loans, and line their own pockets.

132. On April 29, 2008 – in the midst of the Defendants' ongoing fraud – Freddie Mac issued a public filing explaining the Company's multi-million dollar pay packages to the Individual Defendants for fiscal year 2007. The filing listed a variety of "notable accomplishments . . . that have better positioned the company," including Defendants' "market-leading response to early signs of the subprime crisis." Freddie Mac's compensation committee also cited a "successful offering of $6 billion in preferred stock in December 2007, which substantially strengthened [the Company's] capital position." The compensation committee also credited Syron with "leading the home mortgage industry through the subprime crisis."

133. Of course, as discussed more fully above, the Company was not "better positioned" by Defendants' false and misleading statements, and the $6 billion Series Z preferred stock offering the Company pointed to as a success in 2008 was merely a costly response to extreme financial trouble brewing at Freddie Mac brought on by Defendants' gorging on non-prime and non-traditional loans, as well as an act in furtherance of Defendants' fraudulent scheme. In sum, the Individual Defendants were motivated to drive the Company into a financial black hole of non-prime and non-traditional mortgages because they knew they would be rewarded for "leading" the Company to additional market share.

D. Defendants Failed to Disclose Freddie Mac's Risk Exposure to Toxic Non-Traditional and Non-Prime Mortgages

- ***"I would also note that the reason people like me didn't complain about this in 2005 and 2006 was that [Fannie Mae and Freddie Mac] had adopted accounting principles that masked these by the way they defined subprime and Alt-A lending."***

> -- Written Statement of Charles W. Calomiris presented to the Committee on Oversight and Government Reform, United States House of Representatives, December 9, 2008

1. Prior to and During the Class Period, the Market Believed Freddie Mac Had Minimal Exposure to Non-Prime and Non-Traditional Mortgages

134. To be sure, although Freddie Mac was building enormous exposures to non-prime and non-traditional mortgages from 2005 to 2007, the Company adopted accounting practices that made it impossible to detect the size of those exposures, and, prior to and throughout the Class Period, made false and misleading public statements downplaying the huge exposures to these non-prime and non-traditional mortgages in the Company's single-family portfolio.

135. For instance, prior to the start of the Class Period, on May 17, 2007, Cook, speaking at the Lehman Brothers 10th Annual Financial Services Conference, stated "***[a]s we've discussed in the past, at the end of 2006, Freddie had basically no subprime exposure in our guarantee business, and about $124 billion of AAA rated subprime exposure in our retained portfolio.***" Two months later, in a letter to shareholders in July 2007, John Radwanski, Vice President & Assistant Treasurer, Debt Funding wrote ***"[t]he problems in the subprime market have garnered a lot of attention since the beginning of the year. It is important to point out that Freddie Mac has basically no subprime exposure in our guarantee portfolio."*** As set forth more fully below, these false and misleading statements continued into and throughout the Class Period.

136. Investors, analysts and the media were completely deceived by Defendants' lies. A February 27, 2007 *Reuters* article entitled, "Fannie, Freddie Tout Limited Subprime Exposure" noted:

> Mortgage finance companies Fannie Mae (FNM.N) and Freddie Mac (FRE.N) said on Tuesday ***they have little exposure to the troubled subprime mortgage market*** and can help struggling homeowners now in that sector.

* * *

137. In an October 5, 2007 article by Peter Miller titled, "Should Fannie Mae & Freddie Mac Bail Out Private Lenders," RealtyTrac.com Chairman and CEO Jim Saccacio was quoted as saying Freddie Mac was ***"smart enough to ignore the potential for short-term profits and maintain their portfolio standards. The result is that today they [Fannie Mae and Freddie Mac] are secure, they produce profits and they do not require a taxpayer bailout."***

138. On November 23, 2007, the *New York Times* published an article entitled, "Freddie Mac Stumbles on Loans." The article stated, in relevant part:

> It's not just subprime anymore.
>
> Freddie Mac, the government-sponsored mortgage lending enterprise, said this week that enough borrowers are defaulting on loans made this year or last that it needed to mark down the value of the loans by $1.2 billion.
>
> ***How many of those loans were subprime?***
>
> ***None.***

* * *

139. On July 13, 2008, the *USA Today* published an article entitled, "Why the crisis of confidence at Freddie Mac and Fannie Mae," which noted:

> ***Both companies maintain fairly stringent requirements for the mortgages they buy. They don't touch subprime mortgage or many of the exotic types of loans that helped fuel the real estate bubble.*** But as the mortgage market has soured, even prime borrowers – the kinds of borrowers whose loans Fannie and Freddie guarantee – have begun to default.

*   *   *

140. On July 14, 2008, economist Paul Krugman (B.A., Yale; Ph.D., MIT; Nobel Prize in Economics 2008) wrote an op-ed piece in the *New York Times*, demonstrating just how successful Defendants were at deceptively convincing the market that Freddie Mac was not involved in the non-prime and non-traditional mortgage market:

> Partly that's because regulators, responding to accounting scandals at the companies, placed temporary restraints on both Fannie and Freddie that curtailed their lending just as housing prices were really taking off. ***Also, they didn't do any subprime lending, because they can't: the definition of a subprime loan is precisely a loan that doesn't meet the requirement, imposed by law, that Fannie and Freddie buy only mortgages issued to borrowers who made substantial down payments and carefully documented their income***.

*   *   *

141. On July 15, 2008, Senator Christopher Dodd, in his opening statement at the United States Senate Banking Committee hearing on "Recent Developments in U.S. Financial Markets and Regulatory Responses to Them," stated:

> One such fact is that Fannie Mae and Freddie Mac have core strengths that are helping them weather the stormy seas of today's financial markets. They are adequately capitalized. They are able to access the debt markets. ***They have solid portfolios with relatively few risky subprime mortgages.*** They are well-regulated. And they have played a vital role in marinating the flow of affordable mortgage credit even during these volatile times.

*   *   *

142. Even as late as September 26, 2008, after Freddie Mac's financial condition was decimated by the Company's exposure to non-prime and non-traditional mortgages, Defendants had muddied the waters so much that some commentators still believed the Company was not in the

subprime business. In an article of that date on the *Business Week* investing blog entitled "Fannie Mae and Freddie Mac were victims, not culprits," Aaron Pressman[15] ("Pressman") wrote:

> ***Start with the most basic fact of all: virtually none of the $1.5 trillion of cratering subprime mortgages were backed by Fannie or Freddie. That's right — most subprime mortgages did not meet Fannie or Freddie's strict lending standards. All those no money down, no interest for a year, low teaser rate loans? All the loans made without checking a borrower's income or employment history? All made in the private sector, without any support from Fannie and Freddie*.**

* * *

143. There was good reason for the confusion in the market – Freddie Mac's statements regarding its holdings of these extremely risky, exotic loans were false and misleading because Freddie Mac, during the Class Period, categorized non-prime loans as "prime" and employed a private, internal standard to distinguish between "prime" and "non-prime" loans that, as the Individual Defendants knew, differed materially from the standard used by government agencies and generally accepted in the banking industry.

2. Defendants Attempted to Have Their Cake and Eat It Too By Labeling "Non-Prime" Loans as "Prime"

144. Defendants faced a quandary when it came to the Company's purchase and/or guarantee of non-prime and non-traditional default prone loans. They needed to keep Freddie Mac's shareholders believing the Company was a low risk operation, but, at the same time, wanted to pursue the high risk non-traditional business in massive quantities to gain market share under the

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[15] Aaron Pressman is a correspondent in *Business Week's* Boston bureau. He was previously a senior market columnist at *TheStreet.com* and a reporter for *Bloomberg News* in Boston. Prior to that, he was a senior writer at *The Industry Standard*. He also spent 12 years covering finance and technology for a variety of publications in Washington, D.C., and New York.

guise of meeting the Company's ever-increasing affordable housing goals.[16] Defendants therefore created the handy and useful fiction that the Company did not guarantee or buy subprime or other non-prime loans since it only purchased prime loans.

145. A former Manager of Operations and Servicing Manager for Non-Performing Loans, who worked for Freddie Mac until March 2007, stated "we had an expectation that credit losses were going to increase because Freddie Mac bought a lot of subprime loans that weren't labeled subprime when they came in to Freddie Mac."

146. In analyzing non-performing loans, the former Manager of Operations and Servicing Manager for Non-Performing Loans recalled that borrowers "shouldn't have got[ten] their loans in the first place" and only got the loans through SISA loans, no documentation loans, and similar products. She/he stated although the loans were not labeled "subprime," even a short inquiry into the borrower's financial status made it clear these were low quality, risky loans. She/he stated that Director Robert Padgett ("Padgett") and Senior Director William Merrill ("Merrill") definitely knew the loans the Non-Performing Loan group were seeing were very low quality and posed high default risks.

147. The former Senior Loan Analyst stated even though Freddie Mac denied having subprime exposure, it was obvious that the Company was getting heavily involved in buying subprime loans. The Company was "doing business with Ameriquest and Argent and they were the biggest subprime lenders in the industry at the time." She/he recalled Freddie Mac was "doing $1

[16] Affordable housing loans and subprime loans are not synonymous. Affordable housing loans can be traditional prime loans with adequate down payments, fixed rates, and an established and adequate borrower credit history.

billion deals" with these originators and that Countrywide was a major seller of loans to Freddie Mac.

148. Corroborating other confidential witnesses, the former Senior Loan Analyst stated the reason Freddie Mac became so active in buying subprime loans was to try to hit targets for market share. She/he said the Company was fine to do "whatever" to increase market share – if it meant more subprime deals, then so be it. The Company would pre-establish market share goals and do anything to get there, including adjusting underwriting standards to meet those goals.

149. According to the former Vice President of Investor Relations, Freddie Mac relied on low quality loans, such as Alt-A and other non-traditional and non-prime loans, as much as any other financial institution, including the private Wall Street non-agency securitizers. The former Vice President of Investor Relations stated the Investment/Retained Portfolio business was an area of major credit risk exposure because it bore exposure to losses from risky loans. This was true beginning in the 2003-2004 timeframe, even though the business in this portfolio was much smaller than the Guarantee Fee business.

150. The former Vice President of Investor Relations stated that information disclosed in Freddie Mac's regulatory filings and Investor Presentations did not explicitly address loan quality. Although some of the Company's charts referred to "amortization plans," (meaning the basis for the monthly payment amounts, such as interest-only or ARMs), they did not refer to credit quality such as Alt-A or subprime. She/he acknowledged detailed quantitative information about loan quality was necessary for estimating accurately the risk exposure from subprime loans and other non-traditional loans, and the Company's disclosures fell short of a complete statement of accurate quantitative estimates of the risk exposure from specific categories of non-prime loans.

151. A former Transaction Reporting Director recalled the Freddie Mac Credit Department "knew what was in the portfolio and was told not to say anything." She/he stated that "without a doubt they knew about problems in the portfolios."

152. Within the U.S. residential mortgage market, borrowers are generally classified as being within two classifications. The terms "prime," "A paper," "conforming," and "investment grade" are generally synonymous and historically were used to describe loans purchased by the government agencies (Freddie Mac or Fannie Mae). The terms "subprime," letter categories below "A," "non-conforming," "below investment grade," "Alt-A," and "non-prime" are used to denote loans that are not prime. The term Alt-A is shorthand for "Alternative to Agency," which historically meant loans not meeting the published standards of Freddie Mac or Fannie Mae (usually for other than FICO score reasons). The term conforming loan meant it conformed to the published standards of Freddie Mac or Fannie Mae. The subprime mortgage market generally refers to the mortgage loan market associated with borrowers who have risk profile characteristics that are correlated with a high probability of default. The risk level of potential mortgage borrowers is often assessed by reference to FICO scores used by credit rating companies who assess a borrower's credit history and a variety of other factors to help determine a borrower risk of default. It is generally accepted by Federal regulators that a borrower with a FICO score of less than 660 is considered subprime. The use of a FICO score below 660 as a significant point of demarcation between prime and subprime loans goes back to 1995. As noted in January 1997 by Standard & Poor's, "[A] FICO score of 660 [is] the investment-grade score as defined in Freddie Mac's industry letter of August 1995."

153. Thus, the most widely accepted measure of the creditworthiness of a borrower used in the mortgage and consumer lending industry, and which Freddie Mac used and relied upon

heavily throughout the Class Period, is the borrower's FICO credit score. Fair Isaac describes the FICO score, which ranges from 300 to 850, as "the standard measure of US consumer credit risk" and "the recognized industry standard in consumer credit risk assessment."[17]

154. FICO scores are developed from a variety of data in a prospective borrower's credit reports, including payment history, amounts owed to creditors, length of credit history, new credit sources, and the types of credit used. Generally, the higher the FICO score, the better the borrower's credit and the lower the risk of default. The FICO score is a key determinant of whether a given borrower will be classified as "prime" or "subprime."[18]

155. As set forth above, there is a strong presumption in the mortgage lending industry that a FICO score of 660 divides prime and subprime borrowers. The principal definition of "subprime" is found in the Expanded Guidance for Subprime Lending Programs, issued jointly on January 31, 2001 by the U.S. Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision ("OTS"). The guidance advises financial institutions that for elevated levels of credit and other risks:

> [t]he term "subprime" refers to the credit characteristics of individual borrowers. Subprime borrowers typically have weakened credit histories that include payment delinquencies, and possibly more severe problems such as charge-offs, judgments, and bankruptcies. They may also display reduced repayment capacity as measured by credit scores, debt-to-income ratios, or other criteria that may encompass borrowers with incomplete credit histories. Subprime loans are loans to borrowers displaying one or more of these characteristics at the time of origination or purchase. Such loans

[17] In October 2006, Fitch Ratings termed FICO scores the "best single indicator" of mortgage default risk.

[18] According to Fair Isaac, the U.S. median FICO score is in the 720 range. Approximately 27% of the U.S. population has a FICO score between 750 and 799, 15% has a score below 600, and 27% has a score below 650.

have a higher risk of default than loans to prime borrowers. Generally, subprime borrowers will display a range of credit risk characteristics that may include one or more of the following:

- Two or more 30-day delinquencies in the last 12 months, or one or more 60-day delinquencies in the last 24 months;

- Judgment, foreclosure, repossession, or charge-off in the prior 24 months; Bankruptcy in the last 5 years;

- ***Relatively high default probability as evidenced by, for example, a credit bureau risk score (FICO) of 660 or below (depending on the product/collateral), or other bureau or proprietary scores with an equivalent default probability likelihood***; and/or

- Debt service-to-income ratio of 50% or greater, or otherwise limited ability to cover family living expenses after deducting total monthly debt-service requirements from monthly income.

156. OFHEO has described "least credit worthy" borrowers as those below 650 FICO (http://www.fhfa.gov/webfiles/1643/workingpaper071.pdf) and "low FICO" borrowers as those below 659 FICO (http://www.fhfa.gov/webfiles/1165/pricesandfinancing.pdf).

157. Upon information and belief, in February 2003, Freddie Mac's own public guidelines acknowledged the importance of FICO scores and stated "FICO scores objectively evaluate all the information in the Borrower's repository credit file at the time the FICO score was created. Freddie Mac has identified a strong correlation between Mortgage performance and FICO scores."

158. Yet, in the Company's public reports, Freddie Mac used its own definitions – and many times used no definition at all – to purposely and significantly understate the Company's commitment to non-prime and non-traditional loans.

159. For instance, throughout the Class Period, Freddie Mac's public filings noted the Company did "not historically characterize[ed] the single-family loans underlying our PCs and Structured Securities as either prime or subprime. . . ." When Defendants did purport to disclose

information regarding the make-up of the Company's non-traditional mortgage holdings, they did so in a way that was completely misleading to the market.

160. For example, throughout the Class Period, Defendants disclosed the dollar amount of mortgages in the Company's portfolio with FICO scores of less than 620, while withholding information on the vast dollar amount of mortgages with FICO scores of less than 660 – the commonly used score to delineate between subprime and prime. In these same filings, the Company differentiated Alt-A loans – loans with little or no income or other documentation – from subprime loans, again reducing the size of Freddie Mac's apparent commitment to subprime loans.

161. Despite Defendants' definitional machinations and sleight-of-hand, these distinctions are not very important from the perspective of realized losses in the subprime and Alt-A categories; loss rates are very similar for both products as was disclosed by Defendants towards the end of the Class Period. [*See Infra* at VIII (B)].[19] Edward Pinto ("Pinto"), former Chief Credit Officer at Fannie Mae, documented Defendants' "success" in the non-prime and non-traditional mortgage market in his testimony before the House Committee on Oversight and Government Reform held on December 9, 2008:[20]

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[19] The significance of Defendants' false and misleading statements regarding the true risks that the Company had undertaken has been underscored by a research report released by OFHEO in August 2008 entitled, "Recent Trends in Home Prices: Differences across Mortgage and Borrower Characteristics" OFHEO studied house price trends in California and found that house prices on homes purchased by borrowers with low FICOs (defined as less than 660), high loan-to-values (defined as >90% LTV), medium loan-to-values (defined as >75% and <90% LTV – many of which had piggy-back seconds that raised the combined LTV to >90%) or high debt-to-income ratios (defined as greater than 40%) tended to rise further and decline more than high or medium FICOs, low LTVs, or medium or low debt-to-income ratios. These differences as they related to Freddie Mac's portfolio – which were known to Defendants but withheld from investors during the Class Period – have materially exacerbated the performance of large portions of the Company's portfolio.

[20] Attached hereto as Exhibit "C" is a true and correct copy of the Declaration of Edward Pinto in Support of Plaintiffs' Consolidated Class Action Complaint for Violations of Federal Securities

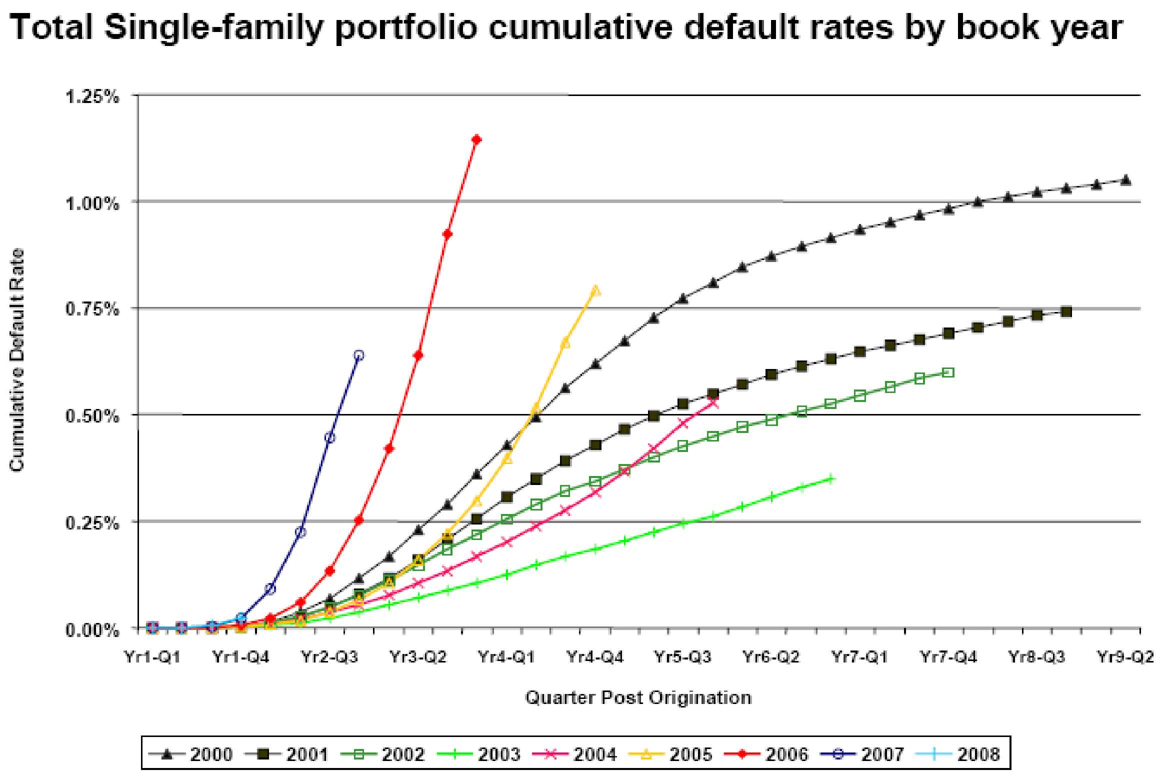
> The GSEs' default rates are skyrocketing. Although they are too new to predict default rates with any certainty, I would expect those portions of Fannie and Freddie's 2005-2007 books consisting of subprime and other default prone loans to experience default rates ranging from 8% for the 2005 originations to 40% for 2007 originations. The GSEs will be responsible for a large percentage of an estimated 8.8 million foreclosures expected over the next 4 years, accounting for the failure of about 1 in 6 home mortgages. Fannie and Freddie have subprimed America.
>
> The losses likely to be suffered by Fannie and Freddie will be a terrible burden to US taxpayers. If the default rates I predict actually occur, US taxpayers will have to stand behind hundreds of billions of dollars of Fannie and Freddie losses.

* * *

162. Based upon Defendants' own revelations, Freddie Mac's 2005, 2006, and 2007 loans had significantly worse default rates than the default rates of prior years, as demonstrated in the graph below. What Freddie Mac never disclosed, however, was the true extent of the Company's non-prime defaults. Instead, Defendants always masked the non-prime defaults by reporting them, without disclosing their existence, as part of the defaults on its traditional loans by book year. Pinto testified non-prime default rates would be significant multiples of those for traditional loans and that non-prime losses account for a substantial majority of Freddie Mac's losses, as demonstrated in the graph below:[21]

Laws (the "Pinto Declaration"). As set forth in the Pinto Declaration and herein, Freddie Mac's exposure to subprime and non-prime loans and securities was substantially greater than indicated by the Company and its representatives' public statements. The effect of these misrepresentations and minimizations was to misrepresent to the public the Company's true financial circumstances and future business prospects.

[21] *See* Freddie Mac's 4th Quarter 2008 Financial Reports Supplement, at 20, available at http://www.freddiemac.com/investors/er/pdf/supplement_031109.pdf.



163. Pinto also documented Freddie Mac's massive participation in the non-prime and non-traditional loan markets in his December 9, 2008 testimony to Congress:

> ***While they may deny it, there can be no doubt that Fannie and Freddie now own or guarantee $1.6 trillion in subprime, Alt-A, and other default prone loans and securities. These comprise over 1/3 of their risk portfolios and amounts to 34% of all subprime loans and 60% of all Alt-A loans outstanding. These 10.5 million unsustainable, non-prime loans are experiencing a default rate 8 times the level of the GSEs' 20 million traditional quality loans. This total includes 5.7 million subprime, 3.3 million Alt-A, and 1.5 million with other high risk characteristics.*** [22]

* * *

[22] In Freddie Mac's March 2009 update, the Company effectively acknowledged the accuracy of Pinto's calculation when it, for the first time, included the FICO category 620-659 in the listing of high risk single-family portfolio characteristics. In Freddie Mac's case this added $164.3 billion in loan balances to its high risk loan listing, making it the second largest category after Alt-A. This also serves as a tacit admission that these loans are subprime.

164. In Freddie Mac's case it had $628.5 billion in subprime, Alt-A, and other default prone loans and securities, amounting to 35% of its credit risk exposure at December 31, 2007.

165. In a January 24, 2009 *Bloomberg* article entitled, "Freddie Seeks Up to $35 Billion From U.S.; Fannie May Follow," Paul Miller, an analyst with FBR Capital Markets stated "[Freddie Mac and Fannie Mae's] losses are going to be much higher than anyone anticipated. ***The more and more that people are digging into these portfolios, they're finding out the more and more these guys were doing subprime and Alt-A loans and classifying them as prime."***

166. A September 2008 article entitled, "The Last Trillion Dollar Commitment – The Destruction of Fannie Mae and Freddie Mac," Peter J. Wallison (the Arthur F. Burns Fellow in Financial Policy Studies at the American Enterprise Institute) and Charles W. Calomiris ("Calomiris") (the Henry Kaufman Professor of Financial Institutions at Columbia Business School) shone a bright light on the true nature of Freddie Mac's non-prime and non-traditional mortgage holdings, based upon partial revelations made by the Company on August 30, 2008 – a little over a week before the end of the Class Period:

> Freddie's disclosures did not contain enough detail to eliminate all of the double counting, so it is not possible to estimate the total amount of its subprime loans from the information it reported. Nevertheless, we can calculate the minimum amount of Freddie's exposure. In the same report, ***Freddie disclosed that $190 billion of its loans were categorized as Alt-A and $68 billion had FICO credit scores of less than 620, so that they would clearly be categorized as subprime. Based on the limited information Freddie supplied, double counting of $7.6 billion can be eliminated, so that as of August 2008, Freddie held or had guaranteed at least $258 billion of junk loans. To this must be added $134 billion of subprime and Alt-A loans that Freddie purchased from private label issuers, for a grand total of $392 billion--20 percent of Freddie's single-family portfolio of $1.8 trillion.***

167. Moreover, subsequent research has determined and confirmed ***Freddie Mac's total non-prime loan exposure was approximately $640 billion – or 32% of Freddie Mac's single-family portfolio***.

168. Indeed, as Defendants disclosed near the end of the Class Period, 52% of the Company's entire single-family credit guarantee portfolio was from book years 2005-2007, with as much as 40% of those loans being junk loans.

169. Thus, Defendants continuously and throughout the Class Period assured the market the Company adhered to a conservative approach to managing mortgage credit risk through underwriting and quality control processes, setting the Company apart from inferior mortgage lenders known to be heavily engaged in subprime and other non-prime. The truth, however, was Defendants were heavily engaged in subprime and non-prime lending with ***50% or more of its single family purchases in each of 2005, 2006, and 2007 consisting of subprime, Alt-A, or other non-prime loans or securities. During 2006 and 2007, Freddie Mac's purchases of subprime private MBS were almost 20% of all such issuances***.

3. Defendants Hid High-Risk Loans in Structured Deals

170. A former Contracts Coordinator who worked for the Company until early 2008 stated Freddie Mac transacted "structured deals" with large investment banks in which the Company procured a significant amount of subprime and junk loans. These deals occurred when investment banks "packaged up junk loans" and sold them to Freddie Mac. The structured deals represented the investment banks "flushing the toilet with their crap" through to Freddie Mac. The former Contracts Coordinator stated the structured deals were executed on at least a daily basis throughout her/his tenure and that, on average, at least one structured deal came across her/his desk every day.

171. The former Contracts Coordinator would review the tape (or list of loans) for the structured deals, which most frequently were coming from large institutions such as Deutsche Bank, Lehman Brothers, Goldman Sachs, Bear Stearns, Merrill Lynch, Morgan Stanley, JP Morgan Chase, and UBS. She/he stated the structured deals were inherently more risky than those bought through the Company's Flow channel, and were more likely to involve subprime loans.

172. Indeed, the former Contracts Coordinator stated the structured deals mainly consisted of subprime loans, such that 60% were comprised of Alt-A loans, but also included ARMs. This former employee acknowledged Freddie Mac could hide the fact that it was engaged in the purchase and retention of subprime loans in its portfolio through MBS deals with investment banks by utilizing a very "strict" definition of "subprime." She/he stated the loans Freddie Mac bought, which included low credit score loans, low down payment loans, ARMs, and Alt-A deals with little or no documentation, were subprime because it was questionable whether the borrowers could actually pay their mortgages. These loans were inherently more risky than conforming loans because the ability to repay was unclear. She/he stated the structured deal loans were definitely "non-guide" or "non-conforming" loans. Given this confidential witness' statements and associated percentages, it is extremely likely many of these loans would have had two or more high-risk characteristics (known as "risk layering"), the presence of which would multiply the ultimate risk of default.[23]

173. For example, Freddie Mac would purchase pools of one type of loan or an investment security backed by one type of loan such as Alt-A loans, stated income, SISA, or "NINJA" loans – "no income, no job or assets loans." She/he stated these were "no job, no income, how are you going to pay your mortgage junk loans." The former Contracts Coordinator said a very high percentage of what Freddie Mac bought were NINJA loans, and that she/he and her/his colleagues at Freddie Mac joked the "crap was running downhill" from the investment banks to

[23] For example, one loan would have a low FICO score, SISA, a high LTV, and be made for investment purposes. In other words, the residential loan borrower had poor credit, non-verified income, and was buying purely on speculation, with no equity in the property underlying the mortgage. The result: a high likelihood of default. This example demonstrates the "risk layering" problem.

Freddie Mac, and the Company was taking on additional risk through participation in structured deals. Through the structured deals, Freddie Mac purchased low quality subprime loans on a daily basis, reminding the former Contracts Coordinator of Enron's special purpose vehicles, and the shifting of assets in and out of such vehicles.

174. The former Vice President of Investor Relations stated Freddie Mac's undisclosed strategy was "intended to create the impression its investment in non-Freddie Mac MBS looked very conservative and boring." She/he noted Freddie Mac took some limited mitigation moves, such as pool insurance and "added collateral" in an effort to "keep this book [of assets] from becoming controversial." But, contrary to Defendants' ruse, the Company's investment in non-Freddie Mac MBS was not conservative.

4. Defendants Used the Company's Antiquated Computing and Accounting Systems to Facilitate Their Fraud

175. Exacerbating the situation was the fact that due to limitations in Freddie Mac's internal systems that did not allow for the Company to properly database or categorize these new exotic loan products, Freddie Mac carried these non-prime and non-traditional loans in databases as prime loans – conveniently allowing Defendants to (falsely) deny that they were active in the subprime market.

176. A former Senior Director of Information Services supporting Single Family-Operations at Freddie Mac's headquarters in McLean, VA, who worked for the Company for 18 years until August 2007, stated she/he engineered the Company's Loan Prospector program in 1994 and that it debuted in 1995. Loan Prospector was used to assign risk ratings to mortgages purchased by Freddie Mac, and is a Java-based platform that automates the loan approval process. It is used throughout the Company, but customers could access Loan Prospector through Freddie Mac's

website. Among other things, the program would retrieve credit information and assign a FICO score.

177. An internal e-mail from Andrukonis dated April 12, 2004 corroborated Freddie Mac's inability to database non-prime and non-traditional loans: "[t]he reasons against [using] L P [to source subprime loans] were LP [Loan Prospector, Freddie's automated underwriting system] weaknesses, if you throw nothing but subprime loans against LP, it will miss some, maybe even a lot."

178. According to a former Operational Risk Manager, the Company's systems simply could not handle the level of risk it was continuously taking on. "When loan offerings expanded [into exotic products], Loan Prospector could not keep up," causing problems to escalate.

179. A former Director of New Product Development stated Loan Prospector was not equipped to adequately analyze or assign risk to subprime and Alt-A loans. As a result, the Company's largest customers began using their own automated underwriting system and foregoing Loan Prospector all together. Yet, Freddie Mac continued to purchase loans from lenders such as Countrywide and other banks, despite the fact that the only due diligence conducted on those loans was done through the lenders' own automated underwriting systems.

180. The former Director of New Product Development recalled the lenders had "more liberal" underwriting standards than Freddie Mac's own automated underwriting system. For example, she/he said the banks may have qualified borrowers for certain loans with a FICO score of 650 when Freddie Mac was supposed to require a score of 700. Or, the banks may have allowed a LTV ratio of 90% when Freddie Mac was supposed to allow no more than 85%. She/he recalled the decision to move away from Loan Prospector had to come from the "highest levels" and the shift occurred about the time that Syron took the helm at Freddie Mac (approximately late 2003). This

sequence of events is supported by published information released by Freddie Mac's regulator, who reported that while LP use was about 65% in 2003, it declined to about 60% in 2004, on its way down to 40% in 2007. *See* OFHEO's Mortgage Markets & the Enterprises in 2007, at 29. This change was necessary so Syron could put into effect the promise he made at the 2004 National Mortgage Banker's Convention, where he declared that a small group of lenders at Freddie Mac would "decide what amount of credit risk we're willing to take at any given time." That, Syron remarked, is a "change of philosophy" for Freddie Mac.

181. A former Manager of Operations and Servicing Manager for Non-Performing Loans recalled that in meetings, the Non-Performing Loans group discussed that the new loan programs, particularly the large number of ARMs, were going to contribute to Company problems. Specifically, she/he stated Freddie Mac's software could not "accept" ARMs – it could only process fixed-rate loans. "There were no systems to do ARM loans" – the systems could not process them, she/he stated.

182. At the same time, Freddie Mac's antiquated computing and accounting systems did not allow the Company to accurately account for the ever expanding types of non-prime and non-traditional loans coming onto the market. Regarding the Company's accounting platforms, the former Senior Business Application Project Manager said they could not track or account for these new, risky loans, and she/he characterized the situation as a "clusterf**k." The objective of this former employee's work was to report on the defects in each of the 11 or 12 accounting platforms used by the Company.

183. For example, Freddie Mac tried to use a program called Eagle to manage its Retained Portfolio, which contained MBS. The attempted implementation of Eagle took years and required an unending (hundreds of thousands) series of "code-drops," which were modifications to

the original software package necessary to tailor the software to handle the work required at Freddie Mac. The former Senior Business Application Project Manager said one of the major categories of issues requiring code-drops was the accounting for the new types of loan programs Freddie Mac was purchasing. This multitude of small "fixes" created a software mess that led to the creation of a department devoted to tracking and managing so-called EUCs [End-User Computing] that comprised the "fixes" for tracking and accounting for certain loan products. She/he said separate spreadsheets were needed to permit the user to make calculations specific, which was a complete nightmare to manage.

184. Similarly, a former Senior Business Analyst stated the Company spent as much as $90 million trying to make the Eagle software program into a usable product for managing Company investments, but in the first quarter of 2008, the Company abandoned the improvement project altogether.

185. The former Senior Business Application Project Manager stated that as evidenced by the existence of the accounting platform improvement project, the fact that the Company's new risky loans and related transactions could not be accurately tracked or accounted for severely hampered efforts to gauge accurately the Company's exposure to credit risk. She/he believed this information had to be known to Freddie Mac's top management, which could not avoid knowing the relaxed constraints in the loan programs and underwriting guidelines would increase credit risk. Top management could not have avoided knowledge of the accounting platform improvement project.

186. This combined knowledge would have created an awareness in Freddie Mac's top management of the inability to accurately assess credit risk. She/he said that certainly by January or February 2007, Defendants had to know the exposure to risk was a "bomb that was ready to go off." None of these underwriting shortfalls, monitoring issues, control insufficiencies or concomitant

increased exposure to the subprime lending market were disclosed by Defendants during the Class Period. To the contrary, as demonstrated below, Defendants consistently touted the quality of the Company's portfolio and the Company's lack of exposure to subprime lending.

187. A former Senior Business Application Project Manager worked on a program concerning approximately twelve very complex projects designed to monitor the variety of accounting platforms Freddie Mac employed to track and account for major aspects of its business. She/he stated the goal of the projects was to bring the systems up to date because they were "antiquated, and not adaptable." The former employee said it was a major problem that Freddie Mac's systems could not be adapted to handle the variety of lower quality loans the Company was buying, securitizing, and guaranteeing particularly during the 2006-2007 timeframe. The fact that risky loans had become increasingly important in Freddie Mac's business while the Company was engaged in a program to improve its ability to assess and manage that risk "must have" alerted top management to its exposure to a potentially very dangerous situation.

188. In addition, a former Senior Loan Analyst stated Freddie Mac would pre-establish loan rejection percentage rates ***before*** Quality Control employees actually reviewed the loans. This former employee was told by superiors that they "need the rejection rate when you go on-site [to review loans] to be at 5%." By pre-selecting an arbitrary number set by the pursuit of market share, not loan quality, it undercut the entire reason for this former Senior Loan Analyst and her/his team to do loan reviews. She/he recalled it frequently was the case that more than 5% of the loans they reviewed did not meet the Company's underwriting standards. She/he stated if "everyone on a five person review team gets to 12% to 18% loans that should be rejected, [the Company] would let it pass and get to 5%" by overruling the decisions made by reviewers in the field. When discussing why she/he and her/his team were being overruled, this former employee was told by her/his

superior that the Company did not want to upset the loan originators and Freddie Mac employees who maintained the relationship with the originators by rejecting "too many" loans. Rejecting "too many" loans could also reduce the Company's tunnel vision pursuit of market share, and would do nothing to increase and maintain the artificial inflation of the Company's equity securities.

189. Similarly, the former Senior Loan Analyst stated for the Company's "aggregator" deals – which were large-scale purchases of Structured Deals from investment banks – she/he was tasked with performing operational reviews of the aggregators, during which she/he could only review twenty-five to fifty ***total*** loans. The former employee said reviews were so minimal that "mostly, we just got to kick the tires" and "reviewed their underwriting guidelines and made suggestions, but they [the investment banks] didn't have to change." The former employee and some others would say they did not like the way the deals were structured, but Freddie Mac Treasury group employees would do the deals anyway.

190. The former Senior Loan Analyst also stated Clayton employees that assisted with on-site loan reviews regularly classified unwaivable underwriting exceptions as waivable. She/he stated that Clayton employees were under tremendous time pressure to review as many files as possible, and they would be sent home by Clayton and/or Freddie Mac if they were not reviewing loan files fast enough. Speed was all that mattered, not accuracy. As a result, the Company regularly accepted loans that violated its own underwriting guidelines.

191. Through the double alchemy of Loan Prospector and other lenders' own automated underwriting systems, along with Freddie Mac's low borrowing costs and high leverage, Defendants were literally able to turn lead into gold. Loans that "passed" one of these systems would now inexplicably be classified as "prime" loans and could be diverted away from private securitizers to

Freddie Mac. By ignoring these weaknesses, Defendants drove up the value of these loans and made mortgage brokers even more eager to find borrowers, no matter what their credit standing.

192. By blending the Company's ever increasing percentage of non-prime and non-traditional loans in with its still sizable low risk book of traditional prime loans, Defendants were able to hide the materially negative impact of the Company's substantial and materially increasing levels of non-prime credit risks.

5. Defendants Turned a Blind Eye to the Enormous Risk the Company was Taking On

a. The Company Changed its Procedures for Assessing Risk and Protecting Against Loss

193. According to the former Senior Loan Analyst, Freddie Mac's underwriting procedures "definitely loosened up as time passed." She/he stated "there was pressure to get in the subprime market, which [the Company] had never been in." The former employee stated the focus at Freddie was "more about doing more and more deals and getting more and more volume than really caring about quality of what we were getting" in loans purchased from originators. She/he stated that for each year from 2002 through 2006, the underwriting and quality control standards got significantly looser in pursuit of a higher volume of loans.

194. By 2006, it "got pretty bad" and the "guidelines kept loosening up." The Company was using other people's guidelines instead of its own and saying it could "price for it." This former employee specifically spoke with Vice President of Alternative Markets Michael Robar ("Robar") about pricing for the increased risk of using other companies' looser underwriting standards. This former employee recalled the pricing adjustments were not even close to a sufficient amount for the risk that Freddie Mac was accepting. Ironically, Freddie Mac's regulator reported that the Company's average guarantee fee was basically unchanged for 2004, 2005, 2006, and 2007, coming

in at 17.5, 16.6, 17.1, and 16.6 basis points, respectively. *See* OFHEO's Mortgage Markets & the Enterprises in 2007, at 34.

195. A former Senior Financial Analyst with the Company's Multi-Family Affordable Housing team stated that beginning in 2006 or early 2007, the Company began to "loosen up" the underwriting standards in order to increase volume. Looking back, she/he recalled how the Company had gotten in trouble in the early 1990s when its underwriting standards were "too loose." At the same time the Company loosened its underwriting, this former employee's group implemented a "delegated underwriting" program, meaning underwriting was outsourced to the Company's largest customers. The underwriting by the Company's largest customers was supposed to be in accordance with Freddie Mac's new, loose underwriting standards. The former Senior Financial Analyst said Freddie Mac implemented the delegated underwriting in order to compete with Fannie Mae and because there was pressure to "bring in more loans."

196. By relying on delegated underwriting, the former Senior Financial Analyst said the Company was assuming more risk and tried to price accordingly. The pricing was designed to be based on presumed risk levels, which were determined based on a sample of loans. The former employee said the Risk Management organization determined pricing.

197. The former Vice President of Investor Relations stated that because the Company purchased MBS from Wall Street firms, it did not conduct proper due diligence and could not understand the riskiness of the underlying loan collateral. Although the acquired MBS were highly rated by ratings agencies, this former Vice President stated the underlying collateral presented risk management challenges Freddie Mac could not overcome. The former Vice President of Investor Relations said Freddie Mac was exposed to toxic loans because to accurately determine the credit quality of the collateral would have required Freddie Mac to perform proper and "incisive due

diligence," which was not done. The former Vice President of Investor Relations stated the Company's top management had knowledge that the Company's transactions involving risky collateral created additional risk exposure.

198. The failure to conduct adequate due diligence was never disclosed to the market and was a serious omission, because 47% of the non-agency MBS held by Freddie Mac had subprime mortgages as collateral, and Alt-A and other risky loans accounted for another 24%, which combined, translated to ***70%*** of the total Freddie Mac non-agency MBS in the Retained Portfolio. The former Vice President of Investor Relations also stated the Company's failure to accurately update internal loan performance information would have contributed to Freddie Mac's problem maintaining an adequate capital base.

199. A former Freddie Mac employee who worked for the Company for 20 years until September 2008 stated that when Freddie Mac first started buying loans from a seller, it did more Quality Control sampling of the loans – reviewing the loans as it bought them to try to catch problems upfront. Freddie Mac, however, began sampling fewer loans and over time there was less and less sampling. Instead, the Company depended on the Freddie Mac Quality Control department to sample 100% of loans ***after default*** rather than making use of sampling upfront. This former employee stated this left Freddie Mac vulnerable to not knowing about problems in loans from a particular seller until after defaults increased.

200. In the past, if Freddie Mac found bad loans in a pool prior to default, the Company would ask the seller to repurchase bad loans. Sellers did not like this practice, however, and Freddie Mac received "poor feedback," with sellers complaining they did not have the money to buy back problem loans. Instead of upsetting its customers, Freddie Mac started preparing "feedback letters" to "educate" customers about only selling Freddie Mac loans that met the Company's guidelines.

Freddie Mac would state in the letters that the loans were not investment quality, but that the customer would not have to repurchase them today, but that if the loans went into default the Company would "revisit" the issue. In other words, Freddie Mac was well aware that it was buying junk loans, and that if the loans went into default, the sellers did not have the financial ability to repurchase them. Nevertheless, the Company continued to buy junk loans and failed to disclose such high risk practices to the market.

201. The former Senior Transaction Manager stated that as part of the Flow transaction agreements, many originators negotiated with Freddie Mac to get "credit waivers," which were agreements that Freddie Mac would buy riskier loans than "normal guidelines" would indicate. She/he stated the risky loans bought by the Company included SISA loans, other "alternative (low) documentation loans" or loans with higher LTV ratios than Freddie Mac would buy from other lenders. One of this employee's duties was to add credit enhancements and secondary market coverage to Flow loans.

202. A former Contracts Coordinator that worked for Freddie Mac from 2006 through January 2008 stated the Company used two types of agreements when buying loans from lenders through the "Flow" channel: Master Agreements and Master Commitments. This former employee stated loans bought through the Flow channel were typically conforming loans underwritten in accordance with Freddie Mac's "guide," which was a set of underwriting standards purportedly used as a basis for determining which loans were eligible to be guaranteed or purchased by Freddie Mac.

203. The Master Agreements contained language about underwriting standards, including the credit scores of borrowers and the various loan limits for loans that Freddie Mac would purchase through the "Flow" channel. The former Contracts Coordinator stated the Master Agreements, however, contained deviations from the "guide" and that these deviations were in the

lender's favor if it was one of Freddie Mac's larger customers. For example, underwriting standards would be waived for larger customers.

204. The former Contracts Coordinator stated the Master Commitments represented more specific contracts subordinate to the Master Agreements. She/he stated the Master Agreements were like an umbrella policy covering all the loans Freddie Mac would purchase in fulfillment of its Master Commitments. The Master Commitments contained details such as the number of particular types of loans Freddie Mac would purchase from a given customer.

205. One confidential witness worked as a Senior Quality Control Specialist for Clayton from late 2004 through mid-2008, and was responsible for auditing loans in various pools of loans being sold by loan originators to entities such as Freddie Mac. Clayton was an outside contractor that provided due diligence services to Freddie Mac. This former Clayton employee recalled auditing two pools of loans Freddie Mac was purchasing that were originated by Washington Mutual, and Freddie Mac was Clayton's "client" in these transactions. She/he stated Freddie Mac was responsible for deciding how many loans in the pool the Clayton auditors would review. The former Clayton employee stated the number of loans audited had dropped from approximately 50% in the 2002 timeframe to as few as 5% of the loans, despite the fact that the size of the loan pools had swelled. She/he emphasized that auditing so few loans in a pool was a problem because not enough loans were being audited to identify trends and/or accurately assess the quality of all the loans in a pool.

206. This confidential witness recalled there were several Freddie Mac Quality Control personnel on site at the Clayton facility in Tampa, Florida during the time Clayton was auditing loans from the pools of loans that Washington Mutual was selling to Freddie Mac. The Clayton employees were given a set of underwriting standards that had been established by Freddie Mac, and

were tasked with reviewing the sample loans from the pool to determine whether they adhered to Freddie Mac's underwriting standards. Loans were rated on a "one" to "three" scale – with "one" being a good loan that met the credit and compliance standards, "two" being a loan that fell outside the guidelines but made sense because of competing factors (such as the borrower's cash position or length of employment), and "three" being loans that were "blatantly beyond the credit and compliance guidelines." Rating a loan a "three" meant Clayton was "kicking the loan" or excluding it from the pool. The number of loans kicked from the pool was used to determine kick ratios, which were regularly provided to Freddie Mac in "descriptive write-ups."

207. A former Senior Transaction Manager stated that mortgage insurers offering pool insurance to the Company's Flow loans were "pretty strict on what they would insure." The pools of loans had to be investment quality loans with normal guidelines. This former employee struggled to communicate that fact to the Company's Quality Control employees who were responsible for underwriting the loans to confirm that Freddie Mac should buy them. She/he stated the Quality Control employees had the misperception that loans with pool insurance can go through with low quality because Freddie Mac would be insured if the loans defaulted. The reality was, however, that low quality loans most likely could not be insured because of the strict standards imposed by mortgage insurers. To address this, the Freddie Mac Credit Tagging Group would classify the loans and not include low quality loans on the list sent up to the mortgage insurer to be insured. In other words, the Company would retain risky loans, and would not have insurance on them. Freddie Mac would buy the junk loans anyway, but not have any credit enhancement (insurance) or other protection against default.

208. The 20-year former employee stated mortgage insurers typically declined to cover non-investment quality loans – loans with high LTV, low or no documentation, or impaired credit

scores. If a mortgage insurer audited a low quality loan sent to it by Freddie Mac, the insurer would notify the Company that it would not cover the loan. Mortgage insurers, however, rarely audited loans upon initiation of coverage. Rather, the insurers would assume Freddie Mac was only requesting coverage for investment quality loans. The former Senior Transaction Manager stated when a loan would go into default, the mortgage insurers would automatically audit the loan file and, at that point, could retroactively decline coverage if the loan initially did not meet the required parameters. The end result, according to this former employee, was that Freddie Mac frequently claimed to have credit enhancements (mortgage insurance) in place that were illusory, and that the illusion would often not be revealed until the underlying loans went into default and coverage was denied. This was a substantial, material risk for Freddie Mac. For example, its largest mortgage insurer was Mortgage Guaranty Insurance Corp. ("MGIC"). MGIC reported that at the end of 2008, it was retroactively declining (rescinding) coverage on 24% of its claims relating to bulk transactions, which generally consisted of subprime, Alt-A, and other non-prime loans. The impact on Freddie Mac could increase, because MGIC believes its rescission percentage ***will continue to rise*** because fraud generally is more prevalent on the newer books of business from 2006 and 2007, and it expects more of the claims in 2009 to be from these books. Freddie Mac has a high concentration of its business from these years.[24]

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[24] For example, on January 20, 2009, in response to a question concerning the number of MGIC's rescissions driven by fraud, Michael Zimmerman, MGIC's Senior Vice President of Investor Relations stated:

> I can tell you it's rising. In the, well the break-out between bulk and flows, so the overall was about 15%, bulk was about 24% and the in flow was about 8%. In the prior quarter of Q3, the overall was about 8, bulk was 13 and the in flow was five. So you can see the trend there and we think it'll continue to rise a bit more because the fraud generally is more prevalent on a newer books of business, '06, '07 and we

209. She/he recalled the Company's Tagging Group could not automatically detect many problem loans, and thus many loans ended up on the monthly list transmitted to mortgage insurers as loans to be covered. She/he stated Director of Pricing Steve Clinton had a "wealth of knowledge" about this problem and that Senior Vice President Bisenius "should have known about any problems." The former Senior Transaction Manager stated lenders were constantly pushing the envelope to see how risky the loans could get to increase the number of potential borrowers. The Company would attempt to charge for the risk by assessing guarantee fees and delivery fees, but, obviously, it was nowhere near enough.

210. A former Manager of Operations and Servicing Manager for Non-Performing Loans stated that Quality Control at Freddie Mac had the authority under seller/servicer contracts to make seller/servicers repurchase loans if they became delinquent or entered default within a certain period of time after Freddie Mac bought it. Although Freddie Mac could have forced seller/servicers to buy loans back, it did not do so on a regular basis because the Company did not want to upset "lender relations." The Company wanted to keep lenders happy so they would continue to sell loans to Freddie Mac. In other words, Freddie Mac would retain loans it never should have purchased in the first place (and subsequently took large losses on), in order to placate lenders and preserve market share. This former employee stated Countrywide, for example, should have been made to repurchase many loans, but the Company would let Countrywide off the hook. Defendants never disclosed this policy, which clearly increased the risks to Freddie Mac's shareholders. This practice is made even more risky given the high rescission rates being experienced with mortgage lenders.

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expect more of the claims over the next year to be '06, '07 thus leading to potentially an increase in the rescission activity from Q3 and Q4.

b. Defendants Tranched "Interest Rate Risk," Not "Credit Risk"

211. The former Vice President of Investor Relations said during the Company's move to increased purchases of private-label MBS with subprime collateral (roughly late 2002), the Company focused its risk concerns on interest rates, not credit risk. Credit risk exposure did not become a focus of management until 2003-2004. At the same time, she/he recalled the Company sought to create the impression its private label MBS purchases did not depart from its usual business practice. The former Vice President of Investor Relations and Vice President of Shareholder Relations Peter Mahoney ("Mahoney") made known to the Company's Disclosure Committee their preference for making maximum disclosures to the market concerning the collateral and the counterparties in the private label MBS transactions. She/he stated the Disclosure Committee was comprised of Freddie Mac's General Counsel, Piszel, and other members of the Executive Committee.

212. A former Director of Mortgage Investor Relations said Freddie Mac did not "tranche" credit risk, but only tranched interest rate risk in the securitization trusts it created when it issued PCs to securitization purchasers. In other words, the degree of risk taken on by a Freddie Mac MBS investor was not based on credit risk, but on interest rate risk. Because Freddie Mac guaranteed the PCs it issued, it retained the credit risk, rather than shifting it to the underlying securitization trusts. In contrast to Freddie Mac, private-label securitizers (such as Wall Street investment banks) did tranche their securitizations with respect to both credit risk and interest rate risk.

c. Though Mortgage Fraud was Rampant in the Market, Fraud Investigation at Freddie Mac was Nonexistent

213. Various studies were completed during the 2005 to 2007 time frame indicating a sharp rise in mortgage loan fraud. A 2007 study by Basis Analytics of 16,000 defaulted residential

mortgage loans found more than 70% contained significant misrepresentations in their respective mortgage loan files. A 2006 study by the Mortgage Asset Research Institute showed that almost 60% of the stated income loans had misrepresented stated income by at least 50%. Also, mortgage fraud complaints more than doubled in the U.S. from 2003 to 2006 according to the Financial Crimes Enforcement Network, a division of the U.S. Treasury Department. Suspicious activity reports pertaining to mortgage fraud increased 14-fold from 1997 to 2005. Notwithstanding the rocketing incidences of mortgage fraud, Freddie Mac hamstrung the Company's own Fraud Investigation Unit.

214. One former Company employee worked as an Operational Risk Manager and assisted with Sarbanes Oxley compliance and Risk Self Assessments for the Company and also worked with the Fraud Investigation Unit. This former employee met several times with the Fraud Investigation Unit's Director, Joan Ferenczy ("Ferenczy") to help her prepare quarterly assessments of the Fraud Investigation Unit prepared by the Company's auditors. There were meetings before the preparation of the assessments called Risk Control Self Assessment meetings. The assessments were designed to look at whether controls or processes changed in the preceding quarter. One quarter during the February 2006 through May 2007 timeframe, when this former employee worked, there was a finding by OFHEO that Freddie Mac lacked the ability to detect fraud on a large scale, but was handling a huge number of loans.

215. OFHEO found the Company needed data mining capabilities to look for fraud on a larger scale. Because the Company lacked a data mining tool, it was relying on a "very manual process" for fraud investigation. With the volume of subprime loans from large lenders, of which only a small sample were reviewed, the Fraud Investigation Unit had to use a manual process because they could not run sophisticated queries of loans in the Freddie Mac system. It was very

difficult to get anywhere near an accurate picture of the level of fraud Freddie Mac was exposed to. This former employee stated CoreLogic was selected as the Company's data mining solution vendor, but that as of May 2007, the solution was not in place.

216. The former Senior Transaction Manager stated the Portfolio Analysis Group did not have a good system for checking the quality of loans or confirming the accuracy of the underwriting. Freddie Mac could determine if the lender tried to deliver a loan that had not been on the initial tape or failed to deliver a loan that was on the tape. But other than matching the identity of the loans between the initial tapes and the loan delivered, there was no real scrutiny on the accuracy of the information on the tapes. "Fraud detection was never happening on these deals."

217. A former Company Senior Loan Analyst stated that in conducting on-site reviews of a sample of loans Freddie Mac was negotiating to buy, Freddie Mac employees were very restricted in checking for fraud or other serious underwriting exceptions. Specifically, this former employee and her/his team of on-site loan reviewers did not use Loan Prospector to confirm the loans met Freddie Mac's standards. She/he stated Loan Prospector could only confirm underwriting sufficiency for loans that could be processed by Freddie Mac Quantum software. This former employee and her/his on-site team always used Clayton software and reporting because "Quantum couldn't handle the loans." Specifically, the Company's loan underwriting software could not handle newer loan products, including 2/28 or 3/27 adjustable rate loans. Indeed, the Company could not use its own software in making judgment calls on pricing. This pricing supposedly gave Freddie Mac the ability to offset the ever-growing risk accompanying the more exotic non-traditional loans Defendants were using to sustain the Company's market share, which in turn artificially inflated the prices of the Company's equity securities.

218. In addition, there were also very limited opportunities to confirm information (*i.e.*, check references or confirm employment) in reviewing loan files. Many loans would only meet underwriting standards if the applicant actually had the job or salary claimed on the loan application. But, many new loan products (which Freddie Mac's software could not handle) did not require proof of job or income – the so-called SISA or NINJA loans. Given time, Freddie Mac employees could have called to confirm applicant information, but according to the former Senior Loan Analyst, they were given no time to do so. She/he recalled they "were expected to review 25 files per day" and that "only if you were virtually certain there was fraud do you call [to confirm information]." On top of that, "if you don't reach someone on the first try, the loan stays in." The Company required such lightning quick turnaround on loan file reviews that significant, material areas of concern either slipped through the cracks or were overlooked altogether.

219. Through the use of these and others tactics, Defendants were able to mask the fact that by mid-2008 the subprime and other non-prime loans in the Company's credit risk portfolio were defaulting at a level eight times the rate for Freddie's traditional high quality loans. As the mortgage crisis developed it became even more necessary to avoid calling its business "subprime" and "non-prime" or its loans unsustainable as these terms came to be identified politically and in the popular press as the root causes of the mortgage crisis. As such, the true impact of the mounting levels of subprime and non-prime loans in the Company's credit risk portfolio remained masked.

220. Throughout the Class Period, Defendants continuously misrepresented to investors that Freddie Mac was a low-risk operation that focused on the prime, conventional, conforming loan market, or as Syron called it "our sweet spot." The real truth was – even excluding the Company's investments in subprime and Alt-A private MBS – Freddie Mac had hundreds of billions in subprime, Alt-A, and other default prone loans and securities, amounting to 29% of its single family

credit risk exposure. In 2007 alone, subprime and non-prime loans comprised almost 53% of Freddie Mac's single family loan and private MBS purchases, making the 2007 book of business the riskiest in the Company's history.

E. Throughout the Class Period, Defendants Knew the Company Was Inadequately Capitalized and Could Not Survive

> ***Fannie Mae and Freddie Mac also engaged in creative accounting making it appear they had capital that just did not exist. At the time of the government takeover, for instance, Freddie Mac had $34.3 billion of paper losses on mortgage-related securities that it did not count towards its calculations of capital requirements***; and Fannie Mae had $11.2 billion of such losses.
>
> -- Testimony of Arthur Levitt Jr., Chairman of the SEC from 1993-2001, to the United States Senate Banking Committee, October 15, 2008

1. In August 2007, the Company Holds Internal Risk Scenario Meetings and Creates a Risk Report: The Individual Defendants Knew the Company Lacked Adequate Capital

221. Prior to and throughout the Class Period, as the Defendants gorged on riskier and riskier loan products, the Company's capital base – unbeknownst to the market and the Company's shareholders – was eroding at a rapid pace. During that time, Defendants received both external and internal warnings that Freddie Mac had dire capital deficiencies and needed to take immediate action to bolster the company's capital position.

222. According to a former Director of Operational Risk Management, many members of the Company's risk organization were assigned tasks designed to mitigate risks relating to the subprime crash. This former employee was aware of the severity and implications to Freddie Mac of the subprime crash as a result of her/his attendance at two of eight or nine "risk scenario meetings" that took place in approximately August 2007 and were held at "PHO IV," an internal designation for the Company's 1551 Park Run Drive office in McLean, Virginia. Among other attendees at the meetings were Senior Vice President of Default Asset Management Beckles, Operational Risk Group Director Davies and Director of Operational Risk Group Assessment

McDermott. The risk scenario meetings were also attended by other director-level personnel and Vice Presidents. The "output" of the risk scenarios meetings was a report authored by Davies. The report was completed after the conclusion of the meetings in August 2007, and was based on the risks that had been identified, the analysis of these risks, and the plans to mitigate the identified risks. The report consisted of "risk triggers."

223. The former Director of Operational Risk Management recalled that the Individual Defendants did not attend the two meetings she/he attended. This former employee stated, however, that Piszel and Cook, and possibly Syron, had to "sign off" on Davies' risk report, so they too were aware of the impending risks and related implications to the Company of the subprime crash at least as early as August 2007. She/he pointed out that risk was managed in such a way at Freddie Mac that those who analyzed the risk, such as Davies, "did not own the risk." Rather, the Individual Defendants "owned" the risk and, therefore, had to "sign off" on the risk.

224. This former employee recalled that just months prior to the risk scenario meetings, Cook made a speech to the Operational personnel. Cook was requesting support in implementing new systems to assist Freddie Mac in "getting into the subprime game." Cook told the Company's Operations staff that Freddie Mac was entering the subprime market to "make more money."

225. Regarding the risk scenario meetings, the former Director of Operational Risk Management stated the number of meetings attended out of the eight or nine total meetings depended on one's role in the risk process and which risks each person was responsible for managing. For instance, Beckles attended the meetings so she could be kept apprised of the number of loan defaults being predicted, as well as to participate in discussions about how many

new staff members she would need to hire and what system improvements would be needed to handle the predicted number of defaults.

226. The former Director of Operational Risk Management stated Davies' report accurately predicted the severity and implications to Freddie Mac of the subprime crash, including details regarding the number of defaulted loans and the devaluation of securities. She/he recalled there were eight or nine different risks, such as the number of defaults and the devaluation of securities, that comprised Davies' analysis. The risk scenario meetings were held to discuss "what would happen" if Davies' predictions materialized, including in the "worst case scenario, and how to deal with the identified risks." In particular, the former Director of Operational Risk Management said the risk scenario meetings were held to evaluate the identified risks from the standpoint of "three main drivers," namely finance, operations, and Freddie Mac's reputation. As an example, she/he said the risk scenario meetings were held, in part, to discuss the amount of capital that would be required in the event of "x" number of defaults.

227. The former Director of Operational Risk Management stated Davies' report identified the various risk indicators used to track the manifestation of the risks and as the basis for triggering responses to the risks. She/he knew the report accurately identified the implications of the subprime crash for Freddie Mac because in late 2006 and early 2007, she/he witnessed the materialization of the risk indicators and triggers Davies identified in the risk reports. She/he recalled that one of the risk indicators that materialized dealt with loan defaults, and that Davies' report predicted the number of defaults experienced would surpass anticipated numbers of defaults that were being debated in the August 2007 timeframe. She/he also recalled that Senior Vice President of Default Asset Management Beckles was scrambling to hire as many people as was possible at the Freddie Mac REO Operations in Dallas, Texas and to try and make sure

Freddie Mac's information systems could handle the number of defaults being internally predicted in the August 2007 timeframe.

228. The former Director of Operational Risk Management stated Freddie Mac did not put the necessary systems and measures in place to deal with the risks identified in the risk report Davies prepared in August 2007. Freddie Mac failed to take any noticeable action in response to Davies' report. The "key risk indicators" identified in Davies' report, including the number of defaults believed to be possible, and related risk indicators, were "coming to fruition" at the end of 2007 and in early 2008. The report triggers detailed certain "thresholds" for events such as delinquencies or defaults on loans. As these "thresholds" were reached at the end of 2007 and in early 2008, Freddie Mac was supposed to enact certain plans to ensure mitigation of risks associated with these events. She/he explained that there were great plans to deal with the risks Davies identified that might have been put in place by September 2007, but by the time the staffing requests and budgets were done, it was December 2007. The risks and related plans also have to be approved by the Company's auditors and OFHEO, which took time.

229. By the time the budgets were approved and the staff and resources were put together to deal with the identified risks, it was the end of the second quarter 2008. This put Freddie Mac a year out from when the risks were identified and by that time, the risk environment had changed even more. Therefore, everything had to go back to the drawing board for new plans. At the same time, the Company's leadership changed as Syron was replaced in the second half of 2008 and Mike Perlman ("Perlman") replaced Joe Smialowski ("Smialowski") as the Executive Vice President of Operations and Technology in August 2007. She/he stated rather than continuing the plans Smialowski had in place to deal with identified risks, Perlman halted efforts to update the Company's systems and instead tried to implement an "alternative platform,"

such as Eagle, that could purportedly handle the volume and type of loans with which Freddie Mac was dealing. The former employee stated Perlman's changes had the effect of halting processes underway to deal with identified risks of the subprime market from the risk report and meetings. In essence, internal risk plans were stalled and never implemented.[25]

230. The former Director of Operational Risk Management stated the statements Piszel made during the Class Period regarding adequacy of Freddie Mac's capital were "bullsh**t." She/he knew this because of her/his knowledge of the risk assessment from the August 2007 meetings, among other things. As this former employee put it, Piszel's statements regarding the Company's capital adequacy were "not substantiated."

231. Indeed, the "key risk indicators" produced by Davies and which resulted from the August 2007 risk scenario meetings were coming to fruition at the end of 2007 and in early 2008, at the time Piszel was making public statements about the adequacy of Freddie Mac's capital. The former Director of Operational Risk Management "absolutely knew" from her/his attendance at the August 2007 meetings that Freddie Mac's capital position was not adequate given the number of defaults that were materializing. She/he recalled statements in particular by Piszel (who had to "sign off" on the risk management reports) about Freddie Mac being "well capitalized" and that "those [subprime] risks are not a threat to Freddie Mac." The former Director of Operational Risk Management stated unequivocally that Piszel's statements were untrue and failed to reveal the failure by Freddie Mac to implement mitigation plans in spite of risk indicators "coming to fruition."

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[25] This former employee said the whole process, in hindsight, seemed more like an exercise to "satisfy OFHEO" rather than a genuine effort by Freddie Mac to mitigate identified and impending risk.

232. The former Director of Operational Risk Management believed other individuals at Freddie Mac shared her/his knowledge that Piszel's statements regarding the adequacy of the Company's capital were false when made. In particular, she/he believed the attendees of the August 2007 risk scenario meetings had to have known Piszel's statements were "bullsh**t." This former employee stated the culture at Freddie Mac, however, was such that even employees with strong ethics would not speak up against false statements like Piszel's because of fear of losing their jobs. As a result, "no one would talk" about Piszel's false statements. She/he stated there was precedent at Freddie Mac – most notably, the termination of Chief Credit Officer Andrukonis – making it clear that anyone who went against or spoke out against Company leadership would be fired.

233. The former Director of Operational Risk Management also recalled "town hall" meetings at Freddie Mac in the 2008 timeframe during which Piszel, Cook, and Perlman spoke about how the media was "making a lot of noise" and that there was a sense of "hysteria" created by the media regarding the subprime crash. The former Director of Operational Risk Management stated that, throughout her tenure with the Company, town hall meetings occurred every two months or so. Beginning in the second quarter of 2008, however, the town hall meetings became more frequent, increasing as the media began to report publicly about potential problems at Freddie Mac. She/he estimated that there were three town hall meetings in the second quarter 2008 during which Cook and Piszel tried to allay employee concerns (with lies) and discredit the media.

234. Cook professed at the meetings that Freddie Mac was the victim of a media frenzy that supposedly falsely made it seem as if the Company was experiencing problems and was not adequately capitalized. According to the former Director of Operational Risk Management, these statements, and others by Piszel, were lies made to lead the employees "astray" and to hide the truth

from them. She/he said that unfortunately, many employees believed what they heard in these town hall meetings, much like the shareholders believed Piszel's statements about the adequacy of Freddie Mac's capital, when such statements were blatantly untrue. She/he recalled Senior Vice President of Enterprise Services Ed Albrigo ("Albrigo") returning from the town hall meetings throughout 2008 and telling his staff (Albrigo's staff) that "Buddy [Piszel] says everything is OK." The former Director of Operational Risk Management and others, including Piszel himself, however, knew Piszel was being untruthful.

235. Moreover, Syron received warnings from Freddie Mac's former head of compliance and oversight, Donald Solberg ("Solberg"), until early 2007 when Solberg left the Company, that the Company's capital base needed to be replenished. Solberg was not the only person to advise Syron that Freddie Mac lacked adequate capital; as reported by the *New York Times*, in 2007 U.S. Treasury Secretary Henry M. Paulson, Jr. ("Paulson") and Federal Reserve Chairman Ben S. Bernanke ("Bernanke") also urged Freddie Mac and Fannie Mae to raise more money and bolster their balance sheets – with Bernanke threatening to publicly chastise the companies if they did not raise more cash. Rather than heeding these warnings, however, Defendants misled investors as to the Company's true capital position, while simultaneously increasing the Company's risk exposure and further degrading its capital.

236. The former Senior Director of Information Services ran a group that provided support to the Company's Capital Management Division, primarily by pulling reports from "Data Warehouse" when inspectors from OFHEO visited Freddie Mac's headquarters to review documents used to create the quarterly capital management reports. She/he said the reports included a breakdown of individual loan rates and the numbers and types of loans held in the Company's portfolio. The report was a summary of the data pulled from Data Warehouse, and was sent to

OFHEO in a memorandum. She/he stated Piszel had to "sign off" on the reports before they were sent to OFHEO.

237. A former Financial Services Consultant stated "inappropriate fair value accounting" for securities was a problem at Freddie Mac during the Class Period, and that applying a "market value" to securities results in "inflated portfolio values." In the case of Freddie Mac, such "inflated portfolio values" were a benefit because they allowed Freddie Mac to appear to be in a better capital position than was actually the case.

238. Regarding the Company's MBS, the former Financial Services Consultant stated when 80-90% of the mortgage-related assets are prime, but the remaining 10-20% are significantly more risky, there is a prolonged process whereby the loans in a given portfolio can be replaced as they "drop out" and default, thereby allowing the portfolio to retain its value. What happened at Freddie Mac, however, was that there were no more performing loans in the market that could be used as replacements for the non-performing loans in the Company's retained portfolio. The inability to replace loans among retained assets required Freddie Mac to have to record losses and/or take a write down on the value of its non-performing assets in its retained portfolio.

239. The former Financial Services Consultant stated the values of Freddie Mac's mortgage-related assets "came from" the front office personnel, and were supplied by large financial institutions and investment banks.

240. The former Vice President of Investor Relations stated the Company's failure to accurately and timely update internal information used in modeling and estimating important quantities such as loan losses, which were necessary to accurately price and adequately manage risk, contributed to Freddie Mac's problem maintaining an adequate capital base. She/he said loan loss

estimates were out-of-date because the Company relied on statistically significant samples of historical data that were not recent enough to capture the changes in the determinants of loan losses.

241. During the 2004-2006 timeframe, a former Director of Mortgage Investor Relations took part in weekly capital meetings in which representatives from different areas of Freddie Mac's business met to determine any changes in the Company's need for capital. She/he said as the market lost confidence in the ability of residential mortgage loan borrowers to perform on their loans, this caused an increase in the credit risk portion of Freddie Mac's portfolios. Freddie Mac was hurt because as assets declined in value, it was supposed to mark down its holdings and recognize losses. When Freddie Mac did so, those changes had significant negative effects on the Company's capital adequacy. She/he said because the Company was so highly leveraged, having borrowed heavily to purchase AAA-rated subprime securities, the huge book losses required Freddie Mac to acquire new infusions of capital to satisfy its capital requirement.

242. Notwithstanding myriad warnings and internal indications that the Company was facing insolvency, Defendants continued to attempt to conceal and misrepresent the Company's financial risk right up until the time that the government placed Freddie Mac into conservatorship.

2. While Defendants were Lying to the Market about Freddie Mac's Sound Financial Position, the Amount of the Company's Non-Performing Loans were Increasing at an Exponential Pace

243. A former Company Financial Analyst Manager, or Accountant, who worked for Freddie Mac for about 5 years between 2003 and October 2008, was among three Accountants assigned to work on "Loans in Acceleration," which involved accounting for delinquent loans. Loans in Acceleration fell under the Company's Non-Performing Loans group, which was part of the Company's Single-Family Operations business line. This former Accountant also handled the accounting for all REO ("Real Estate Owned") properties and the related charge-offs. She/he

worked with two other people who were tasked with buying back from investors loans that were more than 120 days in default. These were loans that had been packaged in the Company's PCs or MBS and sold to investors. A former Senior Financial Analyst working in Single Family Operations from late 2005 through late 2007 said the Loans In Acceleration group was created to deal with subprime and Alt-A loans that were going bad. Indeed, the Company already had a Non-Performing Loans group.

244. The former Accountant also performed accounting for credit enhancements, *i.e.*, insurance, on loans. Freddie Mac could purchase credit enhancements on pools of loans as a way to mitigate risk, but this former Accountant stated that Freddie Mac was not a frequent user of credit enhancements, and she/he wondered why the Company did not use it more often because it made sense on non-traditional loans. The former Company Accountant stated many of the single family mortgages in default that she/he worked with did not have credit enhancements. For example, as revealed in the Company's 2007 Financial Results, only 17% of the Alt-A loans Freddie Mac purchased or guaranteed had credit enhancement.

245. The former Company Accountant detailed a steep increase in the number of loans going into default in 2007 and 2008. By the time she/he left the Company in October 2008, the dollar value of defaulting loans was nearing $1 billion per month. Most of the defaulting loans were tied to the PCs Freddie Mac sold to investors through the Company's Guarantee Fee Portfolio. The former Accountant and one other Accountant performed mark-to-market accounting and charge-offs on loans that were between 120 and 360 days in default. She/he stated that the repurchased loans were not replaced in the PCs, so the total value of the PCs was reduced. Buying back the loan also triggered a write down on Freddie Mac's books. So, if a loan was originally valued at $100,000 and Freddie Mac repurchased it from a PC for $70,000, the Company would have to write off $30,000.

The former Accountant stated the Non-Performing Loans group was doing mark-to-market accounting on these loans as far back as 2006. In 2007, however, the number of loans defaulting was "almost doubling" every month for the entire year. She/he recalled the Company's "exotic loans," *i.e.*, non-traditional loans, were defaulting at a much faster rate than traditional loans and were driving the Company's losses. It was so severe that although non-traditional loans were not necessarily the bulk of loans heading into default, they accounted for approximately 80% of the losses attributed to non-performing loans in 2007.

246. The former Accountant stated the Non-Performing Loans group tracked loans in default for 30, 60, and 90 days, but only repurchased loans that were in default for 120 days. She/he stated the Company was buying back so many loans in default in 2007 that the Company changed its buy-back policy. Instead of buying back loans at 120 days, Freddie Mac would only buy them back once they had been in default for 360 days. ***This policy change occurred because, the former Accountant stated, the write-downs had grown so large.*** She/he estimated the Company was writing down about $1 billion per month at that point. The former Accountant stated ***the change in policy to wait to repurchase loans in default until they were almost one year in default appeared to be an intentional effort to delay the timing of write-offs on non-performing loans, and thereby reduce the total amount of the write-downs being taken on a quarterly basis, and to spread those losses out over a larger period of time.*** This change of policy, enabled the Company to dramatically reduce its apparent capital needs at a critical point when it was under capital pressure and risked being out of compliance with OFHEO capital minimums. This, of course, enabled it to increase or, at the very least, maintain, the artificial inflation of the price of Freddie Mac's equity securities, masking the Company's true financial condition and future business prospects.

247. Among other things, after leaving the Company, this former Accountant followed the public statements made by Company executives in the week or so before the government took control of Freddie Mac. She/he stated that the executives' comments show that they were either "totally lying or just in denial." She/he stated it was obvious the Company's high-ranking executives were "disconnected from reality."

248. The former Manager of Operations and Servicing Manager for Non-Performing Loans was responsible for handling loan modifications, workouts, overseeing servicer relations and making sure servicers were following Freddie Mac loan servicing guidelines. Through her/his work with nonperforming loans, this former employee had a good understanding of coming credit losses and loan problems. She/he stated that throughout the Non-Performing Loan Group, Company employees "knew we were going to experience more credit losses because the economy was going to change." She/he also stated that a lot of loan refinancing over the past several years had been into adjustable rate mortgages that were going to be a problem for the Company when interest rates adjusted.

249. According to a former Senior Servicing Default Specialist with 23 years experience at the Company, the number of non-performing loans increased in mid-2006, and there were concerns among department managers and, as she/he believed, these concerns were shared with Syron. For example, she/he stated that toward the end of 2006, the Non-Performing Loan division was seeing an increase of approximately 100 or more defaults a month compared to the previous year. She/he also estimated that on a monthly basis, about half of the loans she/he tracked were heading into foreclosure prior to mid-to-late 2006. As the housing market continued to struggle thereafter, she/he estimated about 75% of the loans she/he tracked were headed into foreclosure. This former Senior Servicing Default Specialist stated she/he used data concerning these defaulting

loans (which were detailed in an Excel spreadsheet) to "run reports" that were then forwarded to Rhonda Katz ("Katz"). Katz reported to Robert Padgett ("Padgett"), who was a Director overseeing the default specialists in Non-Performing Loans. These reports, which were generated monthly, were shared with Padgett and should have made their way to Ingrid Beckles ("Beckles"), a Vice President in Non-Performing Loans, and on to Syron, as Beckles reported to Syron.

250. A former Senior Financial Analyst that worked for the Company from 1998 to October 2008 in the Company's Non-Performing Loans group also stated the group produced monthly reports listing the single-family loans in default, which were created in a software program called PeopleSoft using data pulled from Data Warehouse. Data Warehouse contained data on loans the Company held in its portfolio as well as the ones it securitized and sold. This former employee's job was to segregate out and analyze losses by geographic region. She/he compiled the information into a report and passed it on to the Company's forecasting group. The reports offered a "big picture" look as what was going on with non-performing loans by geographic region, but Non-Performing Loan analysts could "drill down" further in Data Warehouse to provide detail such as amount of the loan outstanding, the year of issuance, the source of the loan, and more.

251. The former Senior Financial Analyst said the number of defaults in California, Arizona, and Florida were "overwhelming" in 2008 and there was more talk about trying to keep people in their homes because of the cost of foreclosure to Freddie Mac was high. In some states, this former employee said the rates of default rose 30% or more each month.

3. Defendants Manipulated the Company's Loan Loss Reserves Forecasts

252. One former employee was an executive with Freddie Mac from 2003 until 2008 and had considerable experience with various modeling and software packages at the Company, including a valuation engine known as DefCap. This former employee was told by other

knowledgeable Freddie Mac employees that Syron was directly involved in manipulating the Company's Home Price Appreciation assumption that was used as an input in modeling Loan Loss Reserves. She/he recalled that Syron wanted to personally approve the Home Price Appreciation figures after "seeing some initial results" of modeling. In so doing, Syron overrode Freddie Mac's Loan Loss Reserves forecast. This former executive stated the Company knew its models were wrong, but they were also fraudulently manipulated. This former executive was told by other knowledgeable Freddie Mac employees that Syron told Company employees to change the Home Price Appreciation inputs in models to forecast Loan Loss Reserves significantly lower than the actual modeling process had forecast. In other words, the former executive recalled that when "the Loan Loss Reserves forecast was X, and management (Syron) overrode that and said it should be 0.5X, that is what moved the forecast."

253. This former executive stated that Loan Loss Reserves were calculated quarterly and discussed at several meetings prior to being released. For example, for second quarter 2008, ending June 30, 2008, the Loan Loss Reserves data typically became available on approximately July 15th. There would then be meetings between July 15th and July 28th to identify early forecasts and confirm those forecasts matched other modeling information and appeared accurate. Members of Enterprise Risk Management, Credit Loss, and the Accounting Departments would all attend the second quarter Loan Loss Reserves meetings and have a final number by approximately August 2nd. This former executive recalled hearing that it was during these meetings that Syron got involved and began to override the Housing Price Appreciation assumptions. She/he heard from colleagues that the fact that Freddie Mac reported a Loan Loss Reserve number significantly lower than FHFA anticipated ultimately led to the decision to place Freddie Mac into conservatorship. Put simply, FHFA and the

Treasury Department could not believe Freddie Mac's numbers, and decided to take control of the Company.

254. This former executive recalled that efforts to manipulate Loan Loss Reserves were particularly important to Freddie Mac's management because the results directly impacted the adequacy of the Company's capital reserves. She/he believed that management thought by reporting lower Loan Loss Reserves, the Company would appear to have a better capital position and be more likely to continue as an independent entity.

255. A former Senior Risk Analyst who worked for the Company until April 2008, who was responsible for the Company's Loan Loss Reserve Model and performed quarterly credit loss analyses for the Single-Family portfolio, stated her/his work focused on estimates of the impaired portion of Freddie Mac's total loan asset population. Generally speaking, this former employee stated impaired loans were those that were non-performing for at least 90 days, and Freddie Mac's characteristics for an impaired loan included the following: current delinquency; no modifications to the loan; an expectation the loan will remain at least one month past due within the period of impairment; and an expectation the loan will remain seriously past due (90 days or more).

256. The former Senior Risk Analyst said each quarter she/he ran each of the models several times to check the results and disaggregate the data. The models, however, did not permit her/him to discern the extent to which subprime or Alt-A loans in particular contributed to the required Loan Loss Reserve. The data did show that most of the default experienced by Freddie Mac did come from subprime and Alt-A loans. Freddie Mac purchased low quality loans, and, in particular, large numbers of subprime loans that the Company pooled and securitized. After this former Senior Risk Analyst and co-workers ran the models and generated their results, they submitted their results to Swanson, who presented the results, including the Loan Loss Reserve

requirement, to Freddie Mac's Finance Department for review and to ascertain the Company's adherence to FAS 133.

257. There were notable increases in the estimated Loan Loss Reserve requirement in the second quarter of 2007, which were followed by a very steep increase in the third quarter 2007. She/he recalls the Loan Loss Reserve requirement in the third quarter 2007 increased to about three times the level as in the previous quarter, and in the fourth quarter 2007, the total at that time reached approximately $5 billion to $6 billion. In the first quarter 2008, the required Loan Loss Reserve rose to an even higher level. She/he said the "book loss" increased between 2005 and 2006, and increased again from 2006 to 2007, and that those increases drove the required Loan Loss Reserve to increase in the first quarter of 2008. She/he said the loan losses booked in the first quarter 2007 reflected increased losses stemming from loans from 2004, 2005, 2006, and 2007.

258. A former Business Analyst Consultant to Freddie Mac from August 2008 through October 2008 worked for Actualized Consulting. This former consultant was hired to work on a project to automate the internal reporting on credit losses from non-performing loans. The intent of the project was to "speed up the process" for being able to view credit losses. When she/he started on the project, it took 25 to 30 days before managers at Freddie Mac could view credit loss data Freddie Mac had received. Thus, Freddie Mac's management's knowledge of its actual credit losses from non-performing loans was perpetually 25-30 days behind real time.

F. Financial Reporting at Freddie Mac was a Sham

1. Defendants Manipulated the Numbers That Were Provided to the Company's Board of Directors

259. A Former Senior Financial Analyst with the Freddie Mac Multi-Family Affordable Housing Group until mid-2007 had exposure to Freddie Mac's internal financial reporting process. This former employee was responsible for financial reporting for the Multi-Family Affordable

Housing team, and prepared reports used during quarterly Board meetings and "dry-runs" that took place approximately a week before the scheduled quarterly Board meetings. The "dry runs" were meetings attended by Vice President-level personnel, department heads, and executives to review the reports before they were presented to the Board. Defendants Syron, Piszel, and Cook attended the "dry runs" in order to preliminarily review the reports prepared for the Board and provide input about changes to be made to the reports before they were presented to the Board. The "dry runs" were held in a conference room at the Company's 8200 Jones Branch facility.

260. The former Senior Financial Analyst stated that approximately 80% of the time following the "dry runs," she/he was asked to change elements of the reports before they were presented to the Board. In some instances, she/he was asked to remove certain slides, which although it was not changing the Company's numbers *per se,* removing the slide from the reports would have the same effect. For example, when Syron, Piszel, Cook, or other high-ranking executives attended the "dry runs," they did not want the Board to know sales were down for a given month, the feedback from the "dry runs" at times was to remove the slide showing the previous period sales. The result of removing a slide would be that one who reviewed the report might not have the benefit of comparing sales periods and, therefore, would not see that sales were down from previous periods. "A lot of the requested changes" to the reports related to "what to show and what not to show."

261. The former Senior Financial Analyst recalled that data such as forecasting, sales volume, returns, and budget versus actual numbers relating to the Multi-Family Affordable Housing group were included in the reports she/he prepared. The reports also included quarter-over-quarter sales volume, details regarding return on investment, as well as losses and delinquency rates. Importantly, this former employee worked closely with her/his peers in the Single Family Affordable

Housing team to ensure data from both groups was "rolled up" and presented as the results of operations for the Affordable Housing division. Specifically, a member of the Single Family Affordable Housing group typically emailed this former employee with PowerPoint and Excel spreadsheets, and emails containing data to be included in the Affordable Housing reports.

262. The former Senior Financial Analyst recalled seeing losses in the Single Family Affordable Housing Report data, mostly resulting from Alt-A loans Freddie Mac purchased. She/he said the Multi-Family Affordable Housing group needed to know about the Single Family group's losses because her/his team would try to compensate for such losses through increased volume.

2. Defendants Knew that Aspects of the Company's Financial Reporting were "Seriously Deficient"

263. A former Senior Financial Analyst in Freddie Mac's Corporate Financial Reporting and Analysis Group was tasked with gathering, assembling, and examining the data and information required to determine the extent to which Freddie Mac met its disclosure requirements concerning its obligations discussed in Note 2 to the Company's 2006 and 2007 Annual Reports entitled "Financial Guarantees and Transfers of Securitized Interests in Mortgage-related Assets, and to alert her/his supervisor when the data did not support the disclosures.

264. The former Senior Financial Analyst in Corporate Financial Reporting said the Note 2 disclosures were seriously deficient because they did not give separate treatment to two types of transactions. This is because Freddie Mac engaged in two types of transactions in acquiring residential mortgage loans. One type of purchase was a cash transaction (also called a "sale" or "purchase") in which Freddie Mac purchased loans and paid cash to loan originators for them. In that case, Freddie Mac entered the amount of the loan assets acquired on its balance sheet. The second type of transaction was a "swap" in which Freddie Mac had access to a pool of loans from an originator, used those loans as collateral for a securitization, and then swapped the PCs from the

securitization back to the loan originator in return for the loans (in lieu of cash). Swap transactions are subject to FIN 45[26], rather than FAS 140[27] that covers cash transactions.

265. This former employee explained that in Note 2 to the Consolidated Financial Statements, and particularly in Tables 2.2, 2.3, and 2.5, Freddie Mac did not distinguish between these two types of transactions, but combined them and showed the aggregate amount. She/he said the disclosures were deficient because they did not address the guarantees in each type of transaction separately, and instead combined them without providing the separate detail that would provide clarity and transparency. As a result, the disclosures in Note 2 did not comply with the separate accounting rules governing the two categories of loan transactions. Indeed, the FAS 140 requirements are more specific about the need for separate disclosure, because it states what shall be disclosed if an entity has securitized financial assets during any period presented and accounts for that transfer as a sale. FAS 140 deals with securitizations ***other than*** FIN 45 swaps. FIN 45 more implicitly indicates a separate disclosure should be made for swap transactions. The former Senior Financial Analyst in Corporate Financial Reporting said "any reasonable accountant would say they should be shown separately, and should not be combined." Indeed, Piszel reviewed the Company's Note 2 disclosures and knew the disclosures did not show the cash transactions separately, as indicated by, among other things, an e-mail Piszel sent directly to this former employee.

266. Presenting the cash and swap transactions combined caused an unwarranted assumption that the guarantees extended in each type of transaction presented the same level of risk

[26] FIN No. 45 is the Financial Accounting Standards Board ("FASB") provision governing guarantor's accounting and disclosure requirements for guarantees, including indirect guarantees of indebtedness of others

[27] FAS 140 is the Statement of Financial Accounting Standard that governs accounting for transfers and servicing of financial assets and extinguishments of liabilities.

exposure. She/he said the combined treatment masked differences in risk, which affected the guarantee asset and liability amounts shown on the balance sheet.

267. The former Senior Financial Analyst in Corporate Financial Reporting noted the failure to make these separate disclosures demonstrated that Freddie Mac suffered from a serious control problem because its accounting systems were not set up to show the two kinds of transactions separately, which was necessary in order to make separate disclosures. Because of this accounting system deficiency and its concomitant data deficiency, it was impossible for Freddie Mac to know what the quantitative impact was on its financial results.

268. As discussed above, the former Senior Financial Analyst in Corporate Financial Reporting specifically referenced Tables 2.2 through 2.5 in the 2007 Annual Report. Concerning Table 2.2 – "Key Assumptions Utilized in Fair Value Measurement of the Guarantee Asset" – she/he characterized as a "gross deficiency" the fact that this table included data not only on the cash transactions subject to FAS 140, but also included swap transactions subject to FIN 45. Although both types of transactions involve guarantees, and each type of guarantee has an asset (and a liability) component, the guarantee assets stemming from the cash transaction have accounting and financial characteristics different from those concerning the guarantee asset stemming from swap transactions. As a result, different assumptions should apply to each in determining fair value measurement, but this was not reported by Freddie Mac.[28]

[28] Even in the Company's Annual Report released on March 11, 2009, Freddie Mac continues to show the FAS 140 and FIN 45 loan transactions combined without separate detail in Note 2 and the related tables. For example, Table 2.3 in the 2008 Annual Report reflects the "Sensitivity Analysis of the Guarantee Asset (Single-Family Mortgage)" and indicates the sensitivity studies were not done separately for each transaction type – but they should have been. A similar problem exists with Table 2.5 concerning "Details of Cash Flows."

269. The former Senior Financial Analyst in Corporate Financial Reporting said the two types of loan purchases were combined quantitatively and reported together because Freddie Mac did not have data sufficient to permit separate disclosures. The obstacle to disaggregating the information was that Freddie Mac's accounting systems could not provide the data separately – one accounting system managed "loan level" information (information on the loan business) while a different system managed the so-called "securities level" information (information concerning Freddie Mac's MBS). Although the loan accounting system distinguished between swap and cash transactions, the securities level accounting software did not. So, there was no complete set of data that could provide cash transaction data separately from swap transactions data. The two systems could not be interfaced. Along those same lines, she/he stated Freddie Mac's estimates of guarantee obligations, deferred guarantee income, and reserves for guarantee losses were significant figures of questionable accuracy that were based on models what were not necessarily accurate and were subject to management interpretation.

270. The former Senior Financial Analyst in Corporate Financial Reporting said that Piszel reviewed the Note 2 disclosures enough to know these disclosures did not show the cash transactions separately, as required by FAS 140, from the swap transactions. She/he recalled Piszel sent questions about Note 2 to people who prepared the disclosures, including this former employee. For example, she/he recalled receiving an email directly from Piszel containing a question about the "Sensitivity Analysis of the Guarantee Asset (Single-Family Mortgages)" and of the "Other Retained Interests" reported in Tables 2.3 and 2.4, respectively, of the 2006 Note 2 disclosures. Piszel's question related to why the prepayment rate assumptions differed in the two tables. The former employee answered Piszel by explaining the Single-Family Guarantee Assets were "plain vanilla" MBS, so a prepayment rate increase would more likely have a negative effect on the asset value of

the guarantee, and that the Other Retained Interest assets were much more complicated because they were "heavily tranched," and an investor might buy an "interest-only" tranche or a "principal-only" tranche. In an interest-only tranche, a prepayment rate increase would decrease cash flow to the investor. In contrast, a principle-only tranche would provide the investor with income from the borrower's principle payments, and an increase in the prepayment rate would provide a positive impact on the value of the asset. This is an example of the so-called "netting problem," discussed below.

271. Regarding who else knew about the deficiencies in Note 2 to the financial statements, the former Senior Financial Analyst in Corporate Financial Reporting strongly believed other senior management officials knew the disclosures were deficient. She/he knew from discussions with co-workers that management had discussions about this deficiency through 2007 and into 2008. She/he said if Syron did not know, he clearly should have because he signed off on the Annual Report.

272. Another deficiency inherent in Freddie Mac's disclosures in Note 2 resulted from the "netting" effect (mentioned above) it used to present what the financial "shock" (impact) would be on the Company's portfolio of loans or MBS from a 10% increase in prepayments (10% shock). The former Senior Financial Analyst in Corporate Financial Reporting explained in presenting the shock, Freddie Mac was supposed to report only the adverse effect, *i.e.*, the financial impact on the portion of the portfolio that would experience a negative result from a 10% shock. Instead, Freddie Mac presented the ***net effect*** of a 10% shock on the total portfolio – it deducted the negative impacts from the positive ones, even though it was industry practice to report only the pure negative effects. Freddie Mac did not do this, and also did not disclose that it was not conforming to industry practice.

273. The former Senior Financial Analyst in Corporate Financial Reporting stated that because of the netting effect, Freddie Mac reported a lower sensitivity to a 10% shock, which made the portfolio appear to be more stable under the shock than if the pure negative impacts were reported. Freddie Mac's published disclosure about the 10% shock was supposed to represent the result as an ***adverse*** change, and so the disclosure was misleading.

274. The former Senior Financial Analyst in Corporate Financial Reporting said that Freddie Mac's disclosure in Note 2 of its Annual Reports concerning its Indemnifications also was deficient. She/he said the Indemnification disclosure notes that in connection with various business transactions, Freddie Mac provides indemnification to counterparties for claims arising out of breaches of certain obligations (*e.g.*, those arising from representations and warranties concerning loan pools) in contracts entered into in the normal course of business. The Indemnification disclosure also notes that "it is difficult to estimate our maximum exposure from these indemnification arrangements," but that "at December 31, 2007, the risk of any material loss from such a claim for indemnification is remote." As a result, no liability for such claims was recorded on Freddie Mac's balance sheet. This former employee stated that FIN 45 requires disclosure of indemnification as part of the required guarantee disclosures discussed above. Freddie Mac, however, could not provide the specific disclosure required for guarantees or indemnifications because of a significant weakness in its controls. The Company had no comprehensive file of its contracts with the loan originators for the purchase and guarantee of their mortgages, and, as a result, could not accurately report on its indemnification commitments. Put simply, Freddie Mac did not have a data file to support a disclosure concerning potential liability from indemnification, and the Company had no basis for the statement that the risk of material loss from an indemnification claim was remote.

275. One former employee worked at Freddie Mac as a Product Controller for the Retained Portfolio from March 2006 through the end of January 2008, although her/his employment did not officially end until March 31, 2008. The former Product Controller for the Retained Portfolio said her/his role with Freddie Mac was essentially "the CFO for the Retained Portfolio." The former Product Controller for the Retained Portfolio had responsibility for monthly reporting and analytics and "enforcement of impairment accounting rules."

276. The former Product Controller for the Retained Portfolio reported to, and was recruited by, Tracie Ahern ("Ahern"). Ahern reported to and was hired by Senior Vice President Catherin Dondzila ("Dondzila"). Former CFO McQuade recruited Dondzila off Wall Street and Dondzila hired Ahern and, by extension, the former Product Controller for the Retained Portfolio and approximately 15 subordinates under her/him who all had Wall Street backgrounds and experience with FAS 133 accounting.

277. In January 2008, Freddie Mac told the former Product Controller for the Retained Portfolio's New York team of fifteen employees that it was relocating the retained portfolio accounting team from New York to Virginia. None of the team members relocated with the department and all left Freddie Mac was a result. No one went because "we all saw the writing on the wall that this Company is going South fast."

278. The former Product Controller for the Retained Portfolio was a member of a Freddie Mac "Impairment Committee" that examined the approximately $150 billion of non-agency triple-A rated securities that were part of the Freddie Mac retained portfolio. The Impairment Committee met with Freddie Mac front office members who traded those securities, as well as Freddie Mac economists who helped make predictions for the future value of the securities as a function of the future performance of the housing market. The committee had eight to ten members,

including Senior Vice President and Head of the Retained Portfolio Gary Kain ("Kain"), then-Controller Kellerman, Ahern, and representatives from the Risk Management group, the Pricing group, and Freddie Mac economists.

279. The impairments occurred quarterly, so the Impairment Committee met twice per quarter. According to the former Product Controller for the Retained Portfolio, the Impairment Committee held a preliminary meeting shortly after the quarter end and then a final meeting shortly before Freddie Mac released its financial results. The last preliminary meeting that the former Product Controller for the Retained Portfolio participated in before leaving Freddie Mac occurred approximately a week after the quarter close of December 31, 2007, in early January 2008. According to the former Product Controller for the Retained Portfolio, at the preliminary meeting the committee members made recommendations about what should be written down (or impaired) and why.

280. The former Product Controller for the Retained Portfolio was "surprised by the small number of impairments incurred." She/he believed the impairments should have been larger because she/he believed that housing prices were going to continue to fall and the housing market would continue to deteriorate.

281. The former Product Controller for the Retained Portfolio noted that the Impairment Committee relied upon outdated models in making their impairment decisions: "I don't think anyone ever really questioned the models." According to this former employee, the models were based on historical models and they were not appropriate for the markets in late 2007 and 2008. She/he stated, "Prudent risk management involves knowing when to rely on the model and when not to rely on the model." According to the former Product Controller for the Retained Portfolio, the models

were predicting the Company's assets were worth "90 to 95" cents on the dollar, but prices in the market were more like high 70s or low 80s.

282. According to the former Product Controller for the Retained Portfolio, through bulk channel loans that were ultimately securitized, Freddie Mac bought back some of those securities, which it then held in the Company's retained portfolio. She/he stated all the Freddie Mac-owned loans in the retained portfolio were like interparty transactions because those loans were securities that carried the Freddie Mac guarantee. According to this former employee, "[w]e were guaranteeing ourselves." In other words, Freddie Mac had huge financial exposure to itself in these securities. This former employee was told by her/his superiors that Freddie Mac got to account for things differently because it was a GSE and not like any other type of entity.

283. According to the former Product Controller for the Retained Portfolio, Value at Risk ("VAR") is a loss predicting metric that analyzes two assumptions. One is a probability aspect and the other is a time period, such as a day, quarter or year. The VAR predicts risk exposure and is used at JP Morgan, Goldman Sachs and other investment banks to limit the amount of risk traders, trading groups and bank segments can take on without additional authority. According to the former Product Controller for the Retained Portfolio, VAR is a very standard metric on Wall Street that is reported in the SEC filings of JP Morgan and Goldman Sachs. The VAR looks at various possible risks and translates them to a common denominator, which is loss, and uses historical models and statistics to extrapolate to a 95% confidence.

284. According to the former Product Controller for the Retained Portfolio, Freddie Mac had a BlackRock-created Aladdin system that provided a variety of sophisticated valuation tools. She/he recalled Freddie Mac paying $5 million per year for this. The Aladdin system was used by Freddie Mac to generate risk reports and liabilities based on Freddie Mac assets that were all tracked

by Aladdin. The former Product Controller for the Retained Portfolio repeatedly suggested to Kellerman and others that Freddie Mac should run a VAR analysis, which would have been easy to do using Aladdin. The former Product Controller for the Retained Portfolio told Kellerman "let's run VAR, but Kellerman told [him] we're different, we're not Goldman Sachs." This former employee could not understand this as an argument to abandon a prudent generally accepted risk measurement.

285. The former Product Controller for the Retained Portfolio was curious, so she/he "ran VAR reports" after being told that VARs did not matter at Freddie Mac. The VAR at Freddie Mac was $600 million. By contrast, she/he stated the biggest VAR at Goldman Sachs and JP Morgan was $100 million. ***Thus, Freddie Mac had a six times bigger risk exposure than Goldman Sachs or JP Morgan, yet Freddie Mac executives told the former Product Controller for the Retained Portfolio not to worry about VAR***.[29]

286. According to the former Product Controller for the Retained Portfolio, Freddie Mac cut the guarantee fees it charged on loans to "ridiculously low levels like 10 basis points [0.10%] in order to gain market share. Typically [the guarantee fees] were twenty-five basis points or more," but by lowering the guarantee fees, Freddie Mac was able to compete for market share because the Company could provide cheaper money to loan originators.

287. According to the former Product Controller for the Retained Portfolio, the whole point of guarantee fees was to build up reserves to pay for defaults as they occur. By lowering the guarantee fees to only 10 basis points, Freddie Mac "didn't have enough set aside to offset defaults."

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[29] VAR is typically an indicator of market risk, but not credit risk. According to the former Product Controller for the Retained Portfolio, VAR actually ended up under-predicting Freddie Mac losses.

This former employee stated the guarantee fees were all driven by market share and it was discussed internally by Cook and Syron how important it was to maintain market share.

288. The former Product Controller for the Retained Portfolio stated that "[w]e purchased all these mortgages with ridiculously low fees." A lot of the mortgages being written in 2005 through 2007 were riskier loans, but the fees to cover the defaults were reduced, not increased, in the name of maintaining market share.

G. OFHEO's Hands Were Tied

289. OFHEO was an agency within the Department of Housing and Urban Development charged with ensuring the capital adequacy and financial safety and soundness of Freddie Mac and Fannie Mae. Yet, prior to and during the Class Period, due in large part to intense lobbying by Freddie Mac over the past decade,[30] OFHEO lacked any real power to effectively regulate Freddie Mac.

290. In fact, on November 1, 2006 – a year prior to the start of the Class Period, and at a time when Freddie Mac was loading up on exotic loans and securities – former director of OFHEO Lockhart admitted as much when he stated in a speech that if ***"Congress fails to act on legislation this year, OFHEO will not be on the same playing field as other financial regulators. Our field will continue to be tilted toward the enterprises."*** Then, on February 7, 2008, Lockhart told the Senate Banking, Housing and Urban Affairs Committee that the country needed ***"a stronger, single***

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[30] On April 18, 2006, Freddie Mac was fined $3.8 million, by far the largest amount ever assessed by the Federal Election Commission, as a result of illegal campaign contributions. Freddie Mac was accused of illegally using corporate resources between 2000 and 2003 for 85 fundraisers that collected about $1.7 million for federal candidates. Much of the illegal fundraising benefited members of the House Financial Services Committee, a panel whose decisions can affect Freddie Mac. Notably, Freddie Mac held more than 40 fundraisers for House Financial Services Chairman Michael Oxley, R-Ohio.

and unified regulator for the housing GSEs. That regulator needs to have all the powers of the bank regulators and more given the Enterprises' size, systemic importance, and GSE status." Lockhart further testified that ***"[i]n only two of our fifteen years has OFHEO known how much money we had to spend when the year started. Uncertain funding levels and the resulting under-staffing is not the way to run a regulator."***

291. On that same day, Assistant Treasury Secretary David Nason told the Senate Banking Committee to create a new federal regulator for Freddie Mac and Fannie Mae possessing enough authority to review all the risks involved:

> The housing GSEs' regulators have neither the tools, nor the resources, to deal effectively with the current size, complexity, and overall importance of these enterprises. The new housing GSE regulatory agency must be provided (with) specific review authority over the retained mortgage portfolios of Fannie Mae and Freddie Mac.

292. Yet, it was not until July 30, 2008, a little over one month before the close of the Class Period, that reform was passed as part of the Housing and Economic Recovery Act of 2008. The new law created the FHFA, which consolidated the mission and safety and soundness oversight for Fannie Mae and Freddie Mac, and provided much greater authority to that entity in regulating the GSEs than OFHEO ever had.[31]

293. According to a former Senior Examiner of Credit Risk for OFHEO in Washington, D.C. who worked from September 2004 through approximately August 2008, OFHEO had a "total lack of real oversight and control" over Freddie Mac. She/he was on the Freddie Mac examination team during her/his entire tenure with OFHEO, and said OFHEO organized its Office of Examinations to roughly mimic Freddie Mac's organizational structure. The former Senior

[31] On February 6, 2009, the FHFA intervened as a Defendant in this matter.

Examiner of Credit Risk for OFHEO said about 50 OFHEO Office of Examinations employees worked on site at Freddie Mac's headquarters in Virginia, and she/he was one of them. About 80% of the time, her/his group was located in a "bullpen" behind the cafeteria at Freddie Mac.

294. Based on her/his experiences, the former Senior Examiner of Credit Risk for OFHEO said people at OFHEO did not seem to care about what was going on at Freddie Mac. She/he said the federal government guaranteed loans through Freddie Mac, but had no control over what it was guaranteeing, particularly because transactions took place in the secondary mortgage market where the risk associated with the collateral was shifted multiple times. The former Senior Examiner of Credit Risk for OFHEO stated examining Freddie Mac was particularly difficult because the Company was "famous for saying that certain information does not exist, that is, until you find it." These circumstances led this former OFHEO employee to ask her/his superiors, "Are we supposed to regulate Freddie Mac, or coach Freddie Mac?" By coaching, this former OFHEO employee meant coaching Freddie Mac on how to get around the fact the Company was not actually in compliance with its own policies – as a means to avoid the reality of Freddie Mac's non-compliance.

295. The former Senior Examiner of Credit Risk for OFHEO was tasked with attempting to examine the credit risk associated with the composition of loans Freddie Mac purchased. She/he did examinations of credit policy, credit risk, allowance for loan losses, and loan asset quality control. Freddie Mac's credit policy set the standard governing the loan programs it purchased and/or guaranteed, and its underwriting guidelines were one layer of the credit policy. Freddie Mac set forth its credit policy in written documentation and the credit policy dictated the types and amounts of residential mortgage loans and MBS it would buy and guarantee, as well as the practices Freddie Mac followed to manage the risk associated with those purchases and guarantees.

Based on the former Senior Examiner of Credit Risk for OFHEO's examinations, however, it was questionable whether the credit policy actually determined the risk Freddie Mac was willing to accept, or, in contrast, whether Freddie Mac constructed a credit policy to justify the risks it was undertaking.

296. The examinations performed by the former Senior Examiner of Credit Risk for OFHEO and her/his team were aimed at determining whether Freddie Mac's credit policy was appropriate for a GSE, whether loan purchases followed the Company's credit policy, and, in particular, whether the risk actually undertaken was appropriate for a GSE and whether the credit policy correctly controlled the risk.

297. Although Freddie Mac makes public its Seller-Servicer Guide, which contains requirements for determining which loans are acceptable for purchase by Freddie Mac, the former Senior Examiner of Credit Risk for OFHEO stated there was an internal Company document entitled "Credit Policy" that dictated the information included in the Seller-Servicer Guide. The Credit Policy was for internal use only and contained about 600-700 pages, and it covered a number of subjects including credit risk, operations risk, market risk, IT, and corporate governance. In particular, the Credit Policy discussed "risk parameters," such as the dollar amount of particular loan types Freddie Mac was willing to buy, and it was very specific about the characteristics those particular loans should have. The Credit Policy document was approved by the Company's Board of Directors and the CEO, and Syron signed it during his tenure.

298. After the Class period, in testimony before the House Financial Services Committee on September 25, 2008, Lockhart testified that, prior to Freddie Mac's demise, Freddie Mac took on significantly greater risk than OFHEO was able to ascertain:

> ***In retrospect and despite OFHEO's surplus capital requirements, the caps on the growth of their portfolios, and repeated warnings about credit risk, the credit profile***

at both Enterprises followed the market down in 2006 and 2007. They bought or guaranteed many more low documentation, low verification and non-standard ARM mortgages than they had in the past. For example, for the first half of 2007, roughly one-third of the Enterprises' new business was composed of Alt-A (less than standard documentation), interest-only, or Option ARM products, and mortgages with layered (multiple) risk characteristics versus 14 percent in 2005. For Fannie Mae, roughly 28 percent of new business in the first half of 2007 was in Alt-A and interest-only products versus 26 percent in 2005. The quality of their holdings of private-label mortgage securities (PLS) issued by others also deteriorated. The portfolio caps restrained the size of their PLS books, but maturing subprime and Alt-A PLS were replaced by PLS from the much riskier 2006 and 2007 origination years. As house prices turned down, delinquencies, foreclosures, losses on real-estate owned and reserves against future losses soared.

H. Freddie Mac Teeters on the Brink of Insolvency and Is Placed Into Conservatorship

299. On September 7, 2008, despite Defendants' Class Period-long assurances as to Freddie Mac's lack of non-prime and non-traditional loan exposure and the adequacy of its capital, the federal government announced it was placing Freddie Mac (along with Fannie Mae) into conservatorship. By dragging Freddie Mac into conservatorship, the government was to temporarily run Freddie Mac until the Company is on stronger footing.

300. On that same date, the *New York Times* printed an article titled, "Mortgage Giant Overstated the Size of Its Capital Base" which stated, in pertinent part:

> ***The government's planned takeover of Fannie Mae and Freddie Mac, expected to be announced as early as this weekend, came together hurriedly after advisers poring over the companies' books for the Treasury Department concluded that Freddie's accounting methods had overstated its capital cushion, according to regulatory officials briefed on the matter.***
>
> * * *
>
> The Treasury secretary, Henry M. Paulson Jr., who won authority from Congress last month to use taxpayer funds to bolster the companies, always maintained that he hoped never to use that power. But, as the companies' stocks continued to languish, some within the Treasury Department began urging Mr. Paulson to intervene quickly.
>
> ***Then, last week, advisers from Morgan Stanley hired by the Treasury Department to scrutinize the companies came to a troubling conclusion: Freddie Mac's capital position was worse than initially imagined, according to people briefed on those***

findings. The company had made decisions that, while not necessarily in violation of accounting rules, had the effect of overstating the firm's capital resources and financial stability.

Indeed, one person briefed on the company's finances said Freddie Mac had made accounting decisions that pushed losses into the future and postponed a capital shortfall until the fourth quarter of this year, which would not need to be disclosed until early 2009. Fannie Mae has used similar methods, but to a lesser degree, according to other people who have been briefed.

*   *   *

The accounting issues that brought so much urgency to the bailout appear to center on Freddie Mac's capital cushion, the assets that regulators require it to keep on hand to cover losses.

The methods used to bolster that cushion have caused serious concerns among the companies' regulator, outside auditors from Morgan Stanley brought in by the Treasury Department and some investors. For example, while Freddie Mac's portfolio contains many securities backed by so-called subprime and alt-A loans, which are one step up from the riskier mortgages, the company has not written down those loans' values to reflect current market prices.

Executives have argued that because they intend to hold the loans to maturity, they need not write down their value. But other banks and financial institutions have written down the value of those securities, even if they continue holding them, under "mark-to-market" accounting rules. Freddie Mac holds roughly double the securities that Fannie Mae does.

Freddie Mac and Fannie Mae have also inflated their financial positions by relying on deferred-tax assets — credits that the companies have built up over the years that can be used to offset future profits. Fannie maintains that its worth is increased by $36 billion through such credits, and Freddie argues that it has a $28 billion benefit.

But such credits have no value until the companies generate a profit — something they have failed to do over the last four quarters, and something that is increasingly unlikely within the next year. Moreover, even when the companies' profits soared, such credits were often unusable because the companies also had large numbers of affordable housing tax credits, which themselves offset profits.

One analyst estimates the companies, in the future, would have to collect roughly double the profits of the past five years for the credits to become usable. Most financial institutions are not allowed to count such credits as assets in the manner used by Fannie and Freddie.

Regulators and auditors may question the companies' use of deferred-tax credits because they cannot be sold to anyone else and they would disappear in a

receivership. And, if those credits were not counted as assets, both companies would probably fall below the capital threshold they are required to hold.

Finally, regulators are said to be scrutinizing whether the companies were trying to manage their earnings by maneuvering the timing of reserves set aside to offset losses from defaulted loans. Each quarter, both companies have gradually increased their loss reserves — Fannie's reserves today stand at $8.9 billion, and Freddie's at $5.8 billion. However, regulators and auditors felt strongly that both companies should have identified larger potential losses immediately, and set aside much more from the beginning.

Other companies, like private mortgage insurers, have identified much larger losses and have set aside much larger amounts of capital. Fannie and Freddie, however, have delayed the recognition of such losses, dribbling out bad news with each quarterly announcement, suggesting a strategy to manage the recognition of losses.

Finally, regulators are concerned that the companies have mischaracterized their financial health by relaxing their policies on when to recognize a loss on a defaulted loan, according to people familiar with the review. For years, both companies have effectively done that when a loan is 90 days past due. But, in recent months, both companies said they would extend that to two years.

As a result, tens of thousands of loans that previously would have been marked down have maintained their value. The companies have injected their own capital into pools of securities, arguing that new business policies are helping greater numbers of borrowers.

Under conservative accounting methods, such a change in policy should not have any impact on the companies' books. However, people briefed on the accounting inquiry said that Freddie Mac may have been using their new policy to delay recognition of losses.

* * *

I. The U.S. House of Representatives Committee on Oversight and Government Reform Investigates Freddie Mac

301. On December 9, 2008, the U.S. House of Representatives Committee on Oversight and Government Reform (the "Oversight Committee") held a hearing on "The Role of Fannie Mae and Freddie Mac in the Financial Crisis." As part of the Oversight Committee's investigation leading up to the hearing, it obtained nearly 400,000 documents from Fannie Mae and Freddie Mac.

302. According to the opening statement of Oversight Committee Chairman Henry A. Waxman ("Waxman"), those documents ***"make clear that Fannie Mae and Freddie Mac knew what they were doing"*** and that ***"[t]heir own risk managers raised warning after warning about the dangers of investing heavily in the subprime and alternative mortgage market."*** Defendants ignored those warnings so that they could line their own pockets.

303. As the Oversight Committee hearing continued, Representative Carolyn Maloney discussed some of the numerous pleas made by Freddie Mac employees to Syron:

> My constituents are very angry about these bailouts and they want to know why a $100 billion line of credit was given to Freddie and Fannie and why Freddie has drawn down 15 billion (dollars) of that $100 billion line of credit. ***We were looking at what happened, they want to understand what happened, so in preparing we interviewed your former chief risk officer, Mr. David Andrukonis from 2003 to 2005.***
>
> ***He said he held that position and reported directly to you. He told us that during these years, mortgage lenders were making increasing demands for Alt-A loans, loans that had no documentation. He found them risky. I know that in New York many people said it was easier to get a loan with no documentation [than] to pay your rent during these days. And he said, and I quote, "Wall Street became I think pretty adept at packaging securities of loans that we would have considered to be higher risk; that is reduced or very little documentation." End quote.***
>
> ***According to him, big mortgage lenders like Countrywide and Lehman put a lot of pressure on Freddie Mac to buy these risky, no doc, Alt-A loans. And he said these lenders were constantly looking to reduce documentation because it was easier to process the loans then sell them, get fees, and the toxic loans are now what we're confronting.***
>
> ***He said that he reached out to you. He said that he was opposed to these no documentation loans, that he talked to you directly, that he sent you memo after memo outlining to you and the board and others that this was risky and not the right way to go….***
>
> ***But let me say furthermore, – I only have four minutes – furthermore, I'd like to say that he was right, because under your leadership, Freddie Mac bought more than 150 billion (dollars) of no doc Alt-A and according to your most recent SEC report, your company's Alt-A purchases have resulted in more than $8 billion this year in credit losses alone due to these risky products that your chief risk officer said not to buy. When that happened to Mr. David Andrukonis, he was fired. He***

was fired. He felt that you agreed with him, but that you still continued to buy what everyone was saying was high risk.

*   *   *

304. As the hearing continued, Representative Mark Souder questioned Syron on the loosening of Freddie Mac's underwriting standards:

> If fact, if we could put this up – Mr. Syron, on March 30th, 2004 an e-mail from one of your executives. ***The author describes "loosening of Freddie Mac's underwriting standards in order to accommodate risky mortgages that do not require verifying the borrower's income or assets – which is extraordinary." He goes on to write, "These are largely driven by a need to allow lenders to compete with Countrywide's Fast & Easy program and Bank of America's Paper-Saver programs. I view these programs as fundamentally changing the underwriting process for as much as 30-plus percent of the mortgage loans we purchase.***"
>
> Now, the question here is, what were Fannie and Freddie trying to compete with Countrywide's Fast & Easy programs for? I mean, you're supposed to be the more – you're supposed to not be the enabler of risky programs. Where was your check?
>
> Syron: Sir, I would debate whether we were – that this market wouldn't have developed even if we weren't involved in it. I mean, what we saw in the subprime market is the – subprime market developed around that, and – so did that Alt-A market.

*   *   *

305. At that same hearing, several mortgage industry experts who had been given access to the documents produced by Freddie Mac to the Oversight Committee were called to testify concerning Freddie Mac's accounting for non-prime and non-traditional mortgages. For example, Pinto, the former Chief Credit Officer of Fannie Mae from 1987 until 1989 advised the Oversight Committee that:

> ***[f]or historical reasons, these loans [Alt-A, subprime and other non-prime loans] are also carried in databases as prime loans when they were purchased by Fannie and Freddie, which conveniently allowed them to deny that they were active in the subprime market. This created tremendous disclosure problems for the industry, since a massive portion of subprime, Alt-A and other non-prime lending has long been hidden behind Fannie and Freddie's "prime" façade.***

306. Calomiris, the Henry Kaufman Professor of Financial Institutions at Columbia Business School, told the Oversight Committee that:

> ***How could the GSEs' exposures to risky mortgages have grown so large without someone on the outside complaining? Despite the crucial role of the GSEs in promoting the subprime boom and bust, most market observers, including myself, had no idea of the extent of their exposures until recently. As the numerous GSE accounting scandals of the last five years illustrate, accounting transparency has never been a strength at the GSEs; not surprisingly, the GSEs did not disclose the extent of their subprime and Alt-A exposures to the market***.

J. The SEC, the FBI and the U.S. Attorney's Office for the State of Virginia Investigate Freddie Mac

307. Three governmental agencies are currently investigating Freddie Mac due to the fraudulent acts perpetrated by Defendants, as set forth more fully herein.

308. The U.S. Attorney's Office for the Eastern District of Virginia is investigating accounting violations, corporate governance issues, and whether the company adequately disclosed potential risks concerning mortgage-related investments dating back to January 1, 2007.

309. In a similar civil investigation, the SEC is also investigating disclosure, accounting, and corporate governance issues at the Company. Although the investigation is still in its early stages, on October 21, 2008, the SEC subpoenaed documents from the Company and has begun deposing Freddie Mac employees.

310. Finally, the FBI is investigating Freddie Mac as part of its probe into the collapse of the subprime mortgage market – specifically investigating possible accounting violations at the Company that may have resulted in the delay of reporting billions of dollars on certain investments.

K. Freddie Mac's Continuing Losses and Need for More Government Aid

311. Since being forced into conservatorship, Freddie Mac has sought billions in bailout monies –taxpayer-financed handouts of capital. On November 14, 2008, Freddie Mac sought $13.8 billion in aid from the Treasury Department following the announcement of a net loss for the third

quarter of 2008 of $25.3 billion. Then, on February 18, 2009, the Treasury Department announced that the funding commitment to Freddie Mac and Fannie Mae would increase from $100 billion to $200 billion each.

312. That was not enough, however, and on March 11, 2009, Freddie Mac sought an additional $30.8 billion in aid from the Treasury Department following the announcement of a net loss for the fourth quarter of 2008 of $23.9 billion and a net loss of $50.1 billion for all of 2008. Then, on May 12, 2009, Freddie Mac sought an additional $6.1 billion in aid from the Treasury Department following the announcement of a net loss for the first quarter of 2009 of $9.9 billion.

VII. DEFENDANTS' MATERIALLY FALSE AND MISLEADING FINANCIAL REPORTING

313. Defendants' deceptive disguise of Freddie Mac's true exposure to the non-prime residential mortgage market during the Class Period was buttressed by the Company's false and misleading financial reporting. During the Class Period, Defendants turned a blind-eye to an unprecedented and distinctively unique financial crisis and made feigned financial statement "judgments" that constituted nothing less than intentional fraud or conscious misbehavior. Indeed, Defendants made these highly unreasonable failures to record in a desperate attempt to preserve Freddie Mac's scant financial capital and preserve its solvency.

A. Background

314. During 2003, a switch in Freddie Mac's auditors from Arthur Andersen to PricewaterhouseCoopers prompted a reevaluation of Freddie Mac's then existing accounting policies, ultimately giving rise to a restatement of Freddie Mac's previously issued financial statements over a multi-year period.

315. In 2004, OFHEO issued a report associated with a special examination it conducted of Freddie Mac that focused largely on the Company's accounting issues. OFHEO's report

concluded Freddie Mac manipulated its reported earnings and made misleading financial disclosures. Among others, OFHEO found that Freddie Mac knowingly manipulated its reported loan loss reserves, circumvented public disclosure standards to obfuscate accounting transactions, ignored its responsibility for adopting sound accounting practices and control systems and employed strategies that were designed to manipulate its earnings.

316. OFHEO concluded the culture at Freddie Mac was one that allowed, and even encouraged, transacting around GAAP that resulted in "pervasive and persistent" accounting errors in more than thirty different accounting issue groups. As a result, OFHEO recommended a broad range of actions and directed Freddie Mac to maintain a capital surplus of 30% over its minimum capital requirement until such remediation efforts had been fully implemented and were effective.

317. This 30% mandatory target capital surplus remained in effect until March 19, 2008, when, in an effort to increase financial market liquidity, the U.S. government announced a plan to loosen capital restraints on Freddie Mac and Fannie Mae so that they could buy even more mortgage loans. Pursuant to the plan, OFHEO reduced Freddie Mac's mandatory target capital surplus from 30% to 20%, provided that Freddie Mac committed to raise additional capital via the sale of stock or dividend cuts.

318. While OFHEO's reduction in Freddie Mac's mandatory target capital surplus percentage was pitched as its reward to Freddie Mac for issuing annual financial statements following its multi-year, multibillion-dollar accounting scandal, in truth, many of the accounting policy and control deficiencies that caused OFHEO to mandate the surplus in 2004 were not remediated by at least the middle of the Class Period.

319. For example, Freddie Mac's 2007 annual report published in February 2008 disclosed, in part, the following with respect to its material control weaknesses:

> [A]s of December 31, 2007, we have either remediated or implemented the activities we believe are necessary to remediate the material weaknesses in our internal control over financial reporting. Because we have not yet conducted a complete evaluation of the operating effectiveness of our internal control over financial reporting, which would include comprehensive testing of the operating effectiveness of individual controls, we cannot conclude on the effectiveness of our internal control over financial reporting. We may identify additional control issues when we perform operating effectiveness testing of controls or from on-going remediation activities.

320. With respect to its significant control weaknesses, Freddie Mac's 2007 annual report disclosed, in part:

Significant Deficiencies that Existed as of December 31, 2006	**Remediation Progress as of December 31, 2007**	**Remediation Progress as of February 28, 2008**
Guarantee Asset/Guarantee Obligation Governance Our process for valuation of and accounting for our guarantee asset and guarantee obligation was complex, manually intensive and dependent on end-user computing solutions, resulting in an unacceptable likelihood of risk for significant error	Remediation activities implemented	Remediation activities implemented
End-User Computing Controls Our financial reporting processes relied on models and end-user computing solutions (exclusive of those addressed through the Guarantee Asset/Guarantee Obligation Governance significant deficiency described above) that were not subject to adequate controls over their development, nor were they subject to adequate change control procedures	In process	Remediation activities implemented
New Products Governance Our policies and procedures for the introduction of new products were insufficient and related governance processes did not adequately ensure adherence to policies and procedures	Remediated	Remediated
Tax Balance Sheet We do not maintain a tax basis balance sheet to support deferred tax accounting under GAAP, which could result in balance sheet misclassifications and potential income statement adjustments	In process	In process
Controls Over Data Quality Controls over the quality of data used in our financial reporting process were not effective	Remediation activities implemented	Remediation activities implemented
Simplifying Assumptions Our financial reporting process was over-reliant on simplifying assumptions, or manual work around solutions, in the application of our accounting policies. In addition, we did not adequately monitor the potential impact of these simplifying assumptions on the financial statements	Remediated	Remediated

Oversight of Models and Model Applications Our model governance and monitoring procedures (exclusive of those addressed through the Guarantee Asset/Guarantee Obligation Governance significant deficiency described above) did not effectively ensure that changes to and our use of models in our financial reporting process are appropriate	Remediation activities implemented	Remediation activities implemented
Subsequently Identified Significant Deficiencies		
IT Security – Shared IDs We have not consistently executed security controls over system and user accounts that can be used by multiple individuals	(1)	In process
User Access Recertification We have not effectively executed periodic review and recertification of user access to financial applications and related technical platforms	(1)	In process
Consideration of Controls in Application Design Our business or technical design requirements for financial application development projects have not adequately considered requirements for automating process controls	(1)	In process
Pre-Deployment Application Testing and Maintenance Approval We have not consistently executed the appropriate testing of new financial applications prior to their deployment nor have we consistently obtained the appropriate approvals of application maintenance charges	(1)	In process

(1) These significant deficiencies were identified through the material weakness remediation efforts related to Information Technology General Controls - Access to Data and Security Administration and Information Technology General Controls - Change Management. Therefore, "Remediation Progress as of December 31, 2007" is not applicable.

321. Accordingly, the reduction in Freddie Mac's mandatory target capital surplus to 20% from 30% was more a function of the U.S. government's initiative to increase liquidity in the U.S. mortgage market than a true reduction in risk associated with Freddie Mac's accounting practices and control systems.

B. Freddie Mac's Capital

322. As Freddie Mac began to remediate its accounting and control deficiencies, the U.S. housing and credit markets began their well-publicized turn for the worse in the spring and summer of 2007. This downturn decreased the value of the mortgage-backed securities held by Freddie Mac as homeowner defaults increased, thereby putting a strain on Freddie Mac capital.

323. In addition, nearly 40% of Freddie Mac's debt obligations at December 31, 2007 had a maturity date of one year or less. Since Freddie Mac has to roll over many billions of dollars of these short-term obligations each week, it needed to maintain capital sufficient to withstand any inability to roll over its short-term debt obligations due to a lack of market liquidity.

324. Accordingly, by the beginning of the Class Period, Freddie Mac was desperate to raise much needed capital. Given the state of the credit markets and its large capital need, Freddie Mac needed to conduct a common or preferred stock offering. Common shares confer an ownership interest in a company, the right to vote on certain matters, and discretionary dividends. Preferred shares confer an ownership interest, normally have no voting rights, but, most importantly, generally have a fixed dividend. In that respect, they are similar to corporate bonds, which normally pay a fixed return.

325. Raising capital through the issuance of common shares has the unfortunate effect of diluting the ownership interest of current shareholders. The anticipated dilution from a stock issuance can thus depress the price of a stock even before it occurs. If the stock price slumps due to anticipated dilution, the issuer then has to issue even more shares to raise the same amount of capital.

326. Raising capital through the issuance of preferred shares is generally less dilutive than issuing common shares, but if investors know that a company is highly undercapitalized, they will demand a higher dividend or other compensation in the structure of the securities.

327. Thus, when Defendants needed to raise capital in the fall of 2007, they were in a bind. If they were truthful about Freddie Mac's capital needs, the Company's already depressed stock prices would decline even further and they would have to either issue even more common stock to raise the necessary capital, which would likely drive the stock prices down further, or pay burdensome dividends in order to sell preferred shares.

328. Accordingly, Defendants falsely portrayed the Company's capital sufficiency, which enabled Freddie Mac to raise $6 billion in the fourth quarter of 2007 via the issuance of preferred shares. The perpetual preferred stock issuance was priced at $25 per share with a dividend rate of 8.375% fixed for five years, and the issue, if not redeemed, would float after five years at the three-month London interbank offered rate plus 4.16 percentage points, with a floor at 7.875%.

329. As detailed herein, this capital infusion was merely a temporary respite because, as Defendants were well aware (but loathe to disclose), Freddie Mac was saddled with massive other-than-temporary impairments on its subprime, other non-prime, and non-traditional mortgage related assets.

330. OFHEO utilized regulatory standards to assess Freddie Mac's capital adequacy. In this regard, the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, or GSE Act, established Freddie Mac's minimum, critical and risk-based capital standards to determine the amounts of core capital and total capital that Freddie Mac must maintain to meet regulatory capital requirements.[32]

331. For example, the minimum capital standard required Freddie Mac to hold an amount of "core capital" that is generally equal to the sum of 2.50% of its aggregate on-balance sheet assets and approximately 0.45% of various off-balance sheet obligations.[33] As noted above, on January 28, 2004, OFHEO required that Freddie Mac add a 30% surplus to its minimum capital requirement due to the added operational risks ensuing from its deficiencies in accounting, systems

[32] The regulatory capital standards referred to herein were those in existence prior to the Federal takeover of Freddie Mac.

[33] Core capital consists of the par value of outstanding common stock (common stock issued less common stock held in treasury), the par value of outstanding preferred stock, additional paid-in capital and retained earnings, each as determined in accordance with GAAP.

and internal controls. This added 30% surplus to Freddie Mac's minimum capital requirement (reduced to 20% for the March and June 2008 quarters) is referred to herein as Freddie Mac's "directed" minimum capital requirement.

332. The critical capital standard required Freddie Mac to hold an amount of core capital that is essentially equal to one-half of the minimum capital requirement (excluding any added surplus Freddie Mac was required to maintain as a result of operational risks). Failure of Freddie Mac to satisfy the critical capital standard would normally have resulted in the appointment of a conservator.

333. The risk-based capital standard was a cash flow stress test that determined the amount of total capital Freddie Mac was required to maintain.[34]

334. To be classified as "adequately capitalized," Freddie Mac was required to meet both the risk-based and directed minimum capital standards. If Freddie Mac failed to meet the directed minimum capital requirement but exceeded the critical capital requirement during the Class Period, it could not be classified higher than "significantly undercapitalized," which would have limited its ability to make distributions and caused its regulators to take actions to require Freddie Mac to acquire new capital, limit its growth, or restrict it from engaging in activities that created excessive risk.

335. The chart below reflects Freddie Mac's regulatory capital surplus during the Class Period pursuant to each of the aforementioned standards:[35]

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[34] Total capital includes core capital and general reserves for mortgage and foreclosure losses and any other amounts available to absorb losses that OFHEO includes by regulation.

[35] Had OFHEO not reduced Freddie Mac's mandatory target capital surplus from 30% to 20% in March 2008, the Company would have reported a directed minimum surplus of $3.301 billion at March 31, 2008 and a directed minimum *deficit* of $194 million at June 30, 2008.

Quarter Ended	Excess Amount of Directed Minimum Capital	Critical Capital	Risk Backed Capital
September 30, 2007	$871 Million	$22.048 Billion	$25.078 Billion
December 31, 2007	$3.452 Billion	$21.306 Billion	$26.827 Billion
March 31, 2008	$5.995 Billion	$24.249 Billion	$16.113 Billion
June 30, 2008	$2.676 Billion	$24.455 Billion	$22.777 Billion

336. While Freddie Mac's regulators focus on the capital standards noted above, investors generally assess its capital sufficiency based upon an examination of its balance sheet prepared in conformity with GAAP. This capital assessment is generally made by reference to Freddie Mac's reported stockholders' equity, which represents the shareholders' stake in the reported assets of an enterprise.

337. During the Class Period, Freddie Mac's stockholders' equity was the sum of its reported: (1) preferred stock; (2) common stock; (3) additional paid-in capital; (4) retained earnings; and (5) accumulated other comprehensive income minus its treasury stock, as reflected in the following chart:

	September 30, 2007		**December 31, 2007**		**March 31, 2008**		**June 30, 2008**
Preferred Stock, par value	$8,109		$14,109		$14,109		$14,109
Common Stock, par value	152		152		152		152
Additional Paid-In Capital	961		871		857		864
Retained Earnings	29,607		26,909		27,345		26,128
Accumulated Other Comprehensive Income (Loss)	(8,823)		(11,143)		(22,296)		(24,180)
Treasury Stock	(4,186)		(4,174)		(4,143)		(4,125)
Total Stockholders Equity	$25,820		$26,724		$16,024		$12,948

338. As noted in the above chart, Freddie Mac's stockholders' equity increased during the quarter ended December 31, 2007. This increase was largely due to the $6 billion preferred stock offering noted above, which caused the value of Freddie Mac's preferred stock on its balance sheet to increase from $8.11 billion to $14.11 billion during the December 2007 quarter. The $6 billion increase in Freddie Mac's preferred stock was offset by a $2.7 billion decline in its retained earnings during the quarter (largely the result of its reporting a $1.6 billion loss during the quarter), and a $2.3 billion increase in accumulated other comprehensive loss during the December 2007 quarter.

339. As noted in the chart above, the greater than 26% increase in Freddie Mac's accumulated other comprehensive loss during the December 2007 quarter was followed by a gargantuan $11.2 billion increase in Freddie Mac's other comprehensive loss during the March 2008 quarter. Accordingly, in only a ***90 day*** period, Freddie Mac more than ***doubled*** the amount of its other comprehensive losses it had accumulated ***since it first began issuing financial statements***.

340. During the Class Period, Freddie Mac's accumulated other comprehensive loss ("AOCL") was composed of: (1) unrealized losses related to its investments in its available-for-sale securities; (2) unrealized losses related to cash flow hedge relationships; and (3) changes in defined benefit plans, each of which was presented net of taxes. The chart below reflects the changes in the values of each of the above components of Freddie Mac's AOCL, net of tax, during each quarter of the Class Period:

	September 30, 2007	**December 31, 2007**	**March 31, 2008**	**June 30, 2008**
Unrealized gains (losses) on available-for-sale securities	$1,435	$(2,023)	***$(10,467)***	$(2,358)
Unrealized gains (losses) on cash flow hedge relationships	265	249	163	474

Changes in defined benefit plans	1	36	1	-

341. While Freddie Mac's unrealized losses on its available-for-sale ("AFS") securities had a material adverse effect on Freddie Mac's reported shareholders' equity during the Class Period, such losses had no effect on Freddie Mac's reported net income or regulatory capital until they become realized via a sale or a determination was made by Freddie Mac that the value of the securities were impaired on more than a temporary basis.

C. The Residential Mortgage Market

342. As set forth above, within the U.S. residential mortgage market, borrowers are generally classified as being within two classifications: (1) "prime," "A paper," "conforming," and "investment grade;" and (2) "subprime," letter categories below "A," "non-conforming," "below investment grade," Alt-A, and non-prime. Alt-A is shorthand for "Alternative to Agency," which historically meant loans not meeting the published standards of Freddie Mac or Fannie Mae (usually for other than FICO score reasons). The term conforming loan meant it conformed to the published standards of Freddie Mac or Fannie Mae. As stated above, the subprime mortgage market generally refers to the mortgage loan market associated with borrowers who have risk profile characteristics that are correlated with a high probability of default, often assessed by reference to FICO scores. It is generally accepted by Federal regulators that a borrower with a FICO score of less than 660 is considered subprime, with this convention going back to 1995.[36] Notwithstanding Freddie Mac's efforts to mislead its investors and the financial press by utilizing a purposefully very narrow definition of subprime, it is clear from numerous confidential witness interviews that the Company's

[36] As noted in January 1997 by Standard & Poor's, "[A] FICO score of 660 [is] the investment-grade score as defined in Freddie Mac's industry letter of August 1995."

employees, at an operational level, knew Freddie Mac was engaged in the purchase and retention of substantial amounts of subprime loans.

343. In addition to the subprime mortgage market, other higher risk mortgages that have recently grown to prominence in the U.S. are "no income/no asset verification" loans, otherwise known as a "NINA" or "no-doc" loans. These type of mortgages are generally classified as "Alt-A," which are associated with borrowers with FICO scores above 620, but are considered to be higher risk loans because they are originated with reduced or no information verification or borrower documentation. Accordingly, Alt-A mortgages are commonly referred to as "liar loans" by mortgage industry participants – that is, mortgages which were approved without requiring proof of the borrower's income or assets.

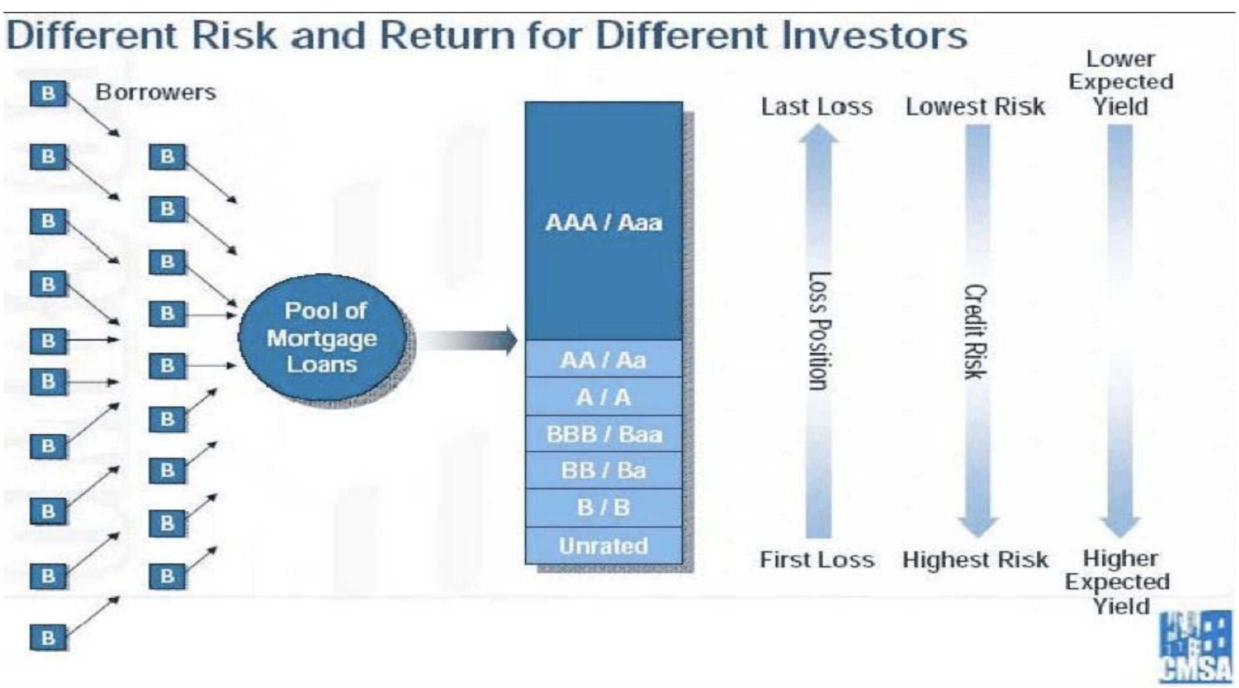
344. An asset-backed security ("ABS") is a security whose value and cash flows are derived from and collateralized by a specified pool of relatively small and illiquid assets. The pooling of these assets facilitates their sale to general investors via a process called securitization. The underlying pools of assets can include assets such as accounts receivables, credit card receivables, auto loans, and mortgage loans. Those ABS whose underlying assets are residential mortgage loans are referred to as a residential mortgage backed security ("RMBS").

345. To create an RMBS, a financial institution, acting as an RMBS sponsor, purchases a large number of residential mortgages (often numbering in the thousands) from bank and/or non-bank mortgage lenders. Usually, the purchased mortgages possess similar characteristics with respect to the quality of the borrower (prime, Alt-A or subprime), so that they can be easily pooled and rated. The pooled mortgages are then sold to a separate, specially formulated, bankruptcy-remote legal entity ("SPE" or "SPV") created by the sponsor, in part, so that sponsors can transfer the mortgages, and their related risks, off of their balance sheets.

346. The SPE or SPV takes title to the individual mortgages and issues bonds or RMBS that are collateralized by the underlying mortgage pool real estate. The RMBSs are issued in tranches, ranging from "High Grade" (AAA and AA-rated bonds), "Mezzanine" (BBB- to B-rated bonds), and an unrated equity tranche, sometimes referred to as the "residual." AAA-rated paper is derived from a pool of subprime mortgages through a prioritization of payments and the apportionment of losses among the different classes of bonds.

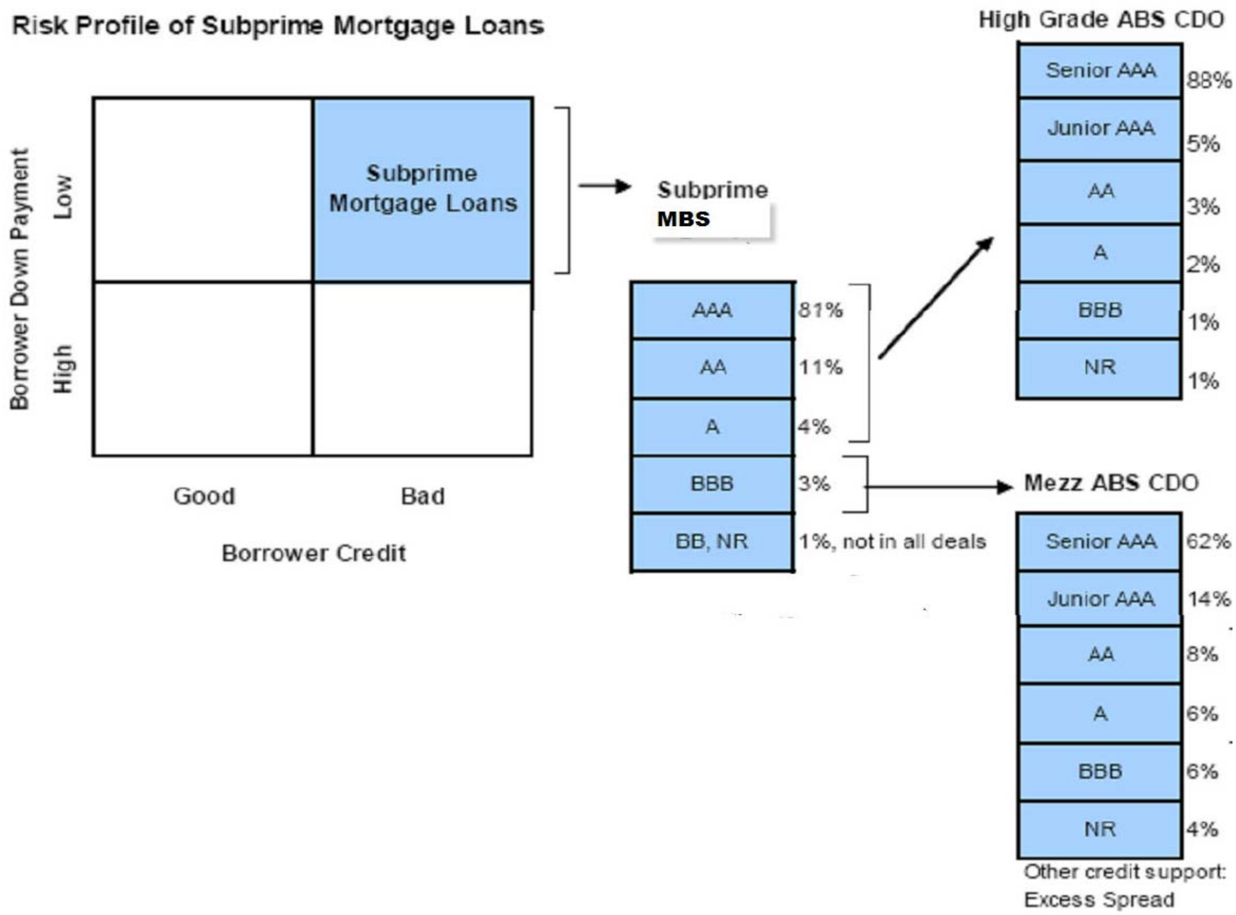
347. Typically, the AAA-rated tranche of the RMBS receive first priority on the cash flows from the underlying mortgages. The investors owning this higher rated RMBS tranche receive a lower interest rate, reflecting less reward for the presumed lower risk. Conversely, the equity tranche holder received the highest return on their investment because the equity tranche is the first tranche to experience losses in the event that the underlying pool of mortgages experience defaults.

348. The following chart illustrates the creation and structure of a typical RMBS issuance:



349. Structurally, collateralized debt obligations ("CDO") very much resemble RMBSs. Similar to a RMBS, CDOs involve a transfer of assets to an SPE or SPV and both involve the issuance of bonds by the SPE or SPV that are collateralized with the transferred assets. The major difference between an RMBS and a CDO is that RMBSs are collateralized by pools of residential mortgages and CDOs are collateralized by a pool of RMBS tranches. Ultimately, however, the RMBS and CDO are collateralized with the same real estate underlying the residential mortgages. Accordingly, a rise in real estate foreclosures will result in a domino-type decline in value of the RMBS and CDO instruments upon which their cash flow is ultimately based.

350. Like an RMBS, CDO bonds are divided into tranches based on a prioritization of payments and the apportionment of potential losses suffered by the underlying RMBS. The following chart illustrates the creation and structure of a typical CDO:



D. Freddie Mac's False and Misleading Financial Statements

351. During the Class Period, Freddie Mac represented that its financial reports during the Class Period were presented in conformity with GAAP.[37] As detailed herein, these representations were materially false and misleading when made, as Defendants knew or recklessly ignored that, among other violations of GAAP, Freddie Mac's financial statements improperly failed to recognize known other-than-temporary impairments on its mortgage-related securities backed by

[37] Regulation S-X [17 C.F.R. §210.4. 01(a)(1)] states that financial statements filed with the SEC that are not prepared in conformity with GAAP are presumed to be misleading and inaccurate.

subprime and Alt-A loans securities.[38] Defendants were motivated to engage in these improper practices to enable Freddie Mac to procure much needed capital at the lowest possible cost and to avoid recognizing losses that would have caused the Company's net worth to fall below the directed minimum capital standards required by regulators.

1. Freddie Mac's Improper Accounting for Its Investments

352. On March 12, 2008, Freddie Mac held its 2008 Investor/Analyst Conference in New York City where Defendants discussed Freddie Mac's 2007 operating results. At that conference, Kain set forth Freddie Mac's deceptive analysis to support its unreasonable failure to record an other-than-temporary impairment in the value of the Company's "available-for-sale" investments:

> [L]et's take a look at an overview of the ABS [asset backed securities] portfolio. As you can see in this slide, Freddie Mac single-family ABS portfolio is comprised of three main asset classes. ***Sub-prime backed ABS is the largest component*** and totals about $100 billion, ***$25 billion of Alt-A backed*** ABS, and approximately $21 billion of securities backed by MTA ARMs [adjustable rate mortgages]. The remainder is comprised of pools backed by HELOCs [home equity lines of credit], manufactured housing loans, closed end second liens, and FHA/VA loans.

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[38] GAAP are those principles recognized by the accounting profession as the conventions, rules and procedures necessary to define accepted accounting practice at a particular time.

A Transparent View of Freddie Mac: 2008 Investor/Analyst Conference

Freddie Mac

ABS portfolio overview

	Product	Total UPB ($ bn)	Monoline wrapped UPB ($ bn)	Credit Enhancement (w/ monoline)	Current 60+ Delinquency
1	Subprime	100.3	3.6	35.8%	21.0%
2	Alt-A	25.1	0.7	16.2%	7.5%
3	MTA ARMs	21.1	0.8	23.2%	7.2%
4	HELOCs	4.5	4.5	100.0%	8.2%
5	MH, Closed-end 2nd Lien, and FHA/VA	3.1	1.2	57.6%	6.1%
6	Totals as of 12/31/07	154.1	10.8	33.2%	16.2%

Now, let me pause for a moment to talk about a few important points about the ABS portfolio. As others have mentioned earlier today, Freddie Mac has no CDO exposure, which is a key distinction relative to other participants that have taken substantial write-downs. All of Freddie Mac's ABS holdings are senior pass-through securities backed by whole mortgage loans. At the time of purchase, approximately 99.8% of Freddie Mac's ABS portfolio was originally rated AAA. As of our earnings release, 85.7% was rated AAA, while just under 30% was on negative watch.

Second, as discussed in more detail in the white paper, our sub-prime securities are considerably shorter than those backing the ABX index and therefore materially safer. Third, ***essentially all of Freddie Mac's ABS securities are classified "as available for sale."*** This is another key distinction. ***As a result, changes in the mark-to-market values do not impact GAAP net income or regulatory capital unless we deem these securities to be "other than temporarily impaired." Freddie Mac has not recorded any impairment on its portfolio of ABS securities in 2007.***

We do not identify any individual securities in the portfolio where principal losses or interest shortfalls were probable. Since the Company has both the intent and the ability to hold these securities until maturity, impairments were not required. Said another way, we believe that unrealized losses on the ABS portfolio as of December 31, 2007, are principally the result of significant increases in market risk premiums and diminished liquidity.

So, let's take a closer look at the sub-prime portfolio. AAA securities backed by sub-prime loans are structured with substantial credit enhancements in order to be able to withstand losses even in extremely poor credit environments. Generally, the enhancements come from three main features: the initial subordination, which

includes subordinate tranches and over-collateralization; excess interest within the trust, which can materially enhance the amount of cash flow available to absorb losses over time; and prepayments, which return principal to our tranches reducing the risk of principal losses and increasing the percentage of credit enhancement available to cover future losses.

A Transparent View of Freddie Mac: 2008 Investor/Analyst Conference

Freddie Mac

Subprime ABS by year of origination

	Underlying Collateral Performance		Credit Enhancement Statistics		
Acquisition Date	Total UPB ($ bn)	Avg Del 60+	Avg CE	Δ CE from Inception	Min. Subord.
2004 & Prior	2.18	20%	75%	27%	16%
2005	22.55	26%	53%	25%	19%
2006	39.56	25%	29%	8%	18%
2007	36.01	13%	30%	2%	19%
Total as of 12/31/07	100.30	21%	36%	10%	16%

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Now, this table gives a high level breakdown of our sub-prime portfolio by purchase year, displays the average credit enhancement information as well as the changes since inception. It also depicts the average percentage of loans that are 60 or more days delinquent. The numbers are the averages for the cohorts shown and it is important to note that the CE [credit enhancements] and delinquency statistics of the individual securities can differ materially from the averages.

Now, let's focus on the average CE column in the middle of the table. Look for a second at the $22.5 billion of 2005 purchases, which had an average CE of 53% as of year-end 2007. Also, notice that this has almost doubled since inception, with CE increasing by 25%. So, what does that mean? If we assume a 50% severity and every loan backing those defaulted, we would have 50% losses. We have 53% credit enhancements and those losses would be covered. Given this, we believe there is negligible exposure on the 2005 and earlier books.

Now, let's look at the 2006 book. Average credit enhancement levels were 29% at year-end. Additionally, CE has increased since inception even on the 2006 book by 8%. Again, this demonstrates the positive impact excess interest and pre-payments can have even on a weaker performing book. Now, if we assume a 50% severity, the 29% CE would absorb all losses even if 58% of the outstanding loans defaulted tomorrow.

Realistically, given the relatively long timelines for default and given that only 25% of the loans were 60 plus days delinquent at year-end, it would take a number of years to -- for losses to flow through to the trusts. Over that time, excess interest should have increased credit support by a material amount. Let's use 8% for example. In that case, the CE would have improved from 29% plus 8% to 37%. We could then absorb 74% defaults, again assuming the 50% severity.

For this reason, we feel the bulk of the 2006 book is also well positioned to withstand further deterioration in market conditions. ***In the interest of time, I want to point you to the aggregate 60 plus delinquency number on the bottom of the page. The 21% at year-end, that implies that just under 80% of the loans were either current or less than 60 days delinquent. Even for the 2006 book, 60 plus delinquencies were around 25%. Again, that means that 75% of the loans backing these deals were either current or less than 60 days delinquent.***

Now, let's turn to the next slide and I will show you what happens when we stress test the portfolio. In an effort to stress test our ABS portfolio, Freddie Mac tested every security in the portfolio as of December 31, 2007. The results of these tests show low levels of projected losses in all of the scenarios. The base scenario ran every security using a default rate of 50% of the total existing collateral as of 12/31 and a severity of 50%. This scenario should be considered against the backdrop of the 21% delinquency number that we just talked about. The 50% severity assumption is also higher than the recent experience for first lien sub-prime loans.

A Transparent View of Freddie Mac: 2008 Investor/Analyst Conference

Freddie Mac

Subprime portfolio stress tests - $ 100.3 Billion UPB

Stress Scenario[1] (60+ del. is 21% at 12/31/07)	Projected Net Present Value of Losses[2]	Projected NPV of Losses as a % of Par Amount	% of Par Amount Recovered
Base Stress (50% default, 50% severity)	$1 million	< 0.01%	> 99.99%
Severity Shock (50% default, 60% severity)	$22 million	0.02%	99.98%
Default Rate Shock (60% default, 50% severity)	$99 million	0.10%	99.90%
Default and Severity Shock (60% default, 60% severity)	$1.1 billion	1.10%	98.90%

[1] Defaults are run at a constant rate where all defaults occur within a 6 year period producing an average time to default of just under two years. Prepayments were run assuming a 10 percent CPR until 24 months and then 15 percent CPR thereafter.

[2] Net present value assumes both principal write downs and interest shortfalls are discounted at forward LIBOR rates.

Note: Stress tests assume monoline insurers cover losses on the $3.55 billion in insured securities.

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Under this scenario, less than $1 million in total net present value losses were projected. While we ran the 50% average -- while we believe the 50% average severity is reasonable, we also ran a more stressful scenario where we assumed a 60% severity. While some types of loans probably will have severities at or above

> 60%, there will be a reasonable quantity of loans, which will have much lower severities, which should help to contain the average.
>
> Even under this scenario, net present value losses were $22 million or 0.02% of the portfolio. We also stressed the defaults assumptions. We used a 60% default rate, which is almost three times the 60 plus delinquency number. This scenario produced just under $100 million in net present value losses.
>
> Lastly, we decided to shock both the default and the severity numbers together. We ran every individual security -- every individual security in the pool -- in the portfolio using a 60% default rate and a 60% severity. While we believe this scenario is more appropriate as a stress test for some of the weaker components of the portfolio, we still applied it to every security. This more extreme scenario generated net present value losses of just over approximately $1.1 billion or just over 1% of the portfolio.
>
> Let's put this in prospective. That still means that we would recover almost 99% of the par value of the portfolio even if six out of 10 loans defaulted at a 60% severity. Now, these stress tests run on every individual security in the portfolio, reinforce the earlier conclusion from the previous slide about the effectiveness of the credit enhancements. With respect to impairments, a loss under one of these stress scenarios would have to become probable for us to impair an individual security.
>
> ***Losses that are merely possible do not trigger impairments. So, in closing, despite the continued deterioration of the housing market and increases in non-prime delinquencies for the reasons discussed, we remain comfortable with our exposure to these assets.*** [Emphasis added.]

353. As a result of these materially false and misleading statements, the price of Freddie Mac common stock was artificially inflated even more, rising 6.3% on March 13, 2008 to $21.30, while the preferred stock increased as much as $2.94.

354. As the above statements acknowledge, Defendants devined a series of analyses, tests and pretexts in an attempt to evade the standards set forth in GAAP requiring them to record an other-than-temporary impairment in the value of Freddie Mac's ABS subprime and Alt-A mortgages securities that it classified as AFS investments in its Class Period financial statements. Defendants engaged in these deceptions in the guise of calling them accounting "judgments" in a desperate attempt to preserve Freddie Mac's solvency and avoid recognizing losses on such investments that would have wiped out the Company's scant financial capital.

355. As noted below, Defendants knew or recklessly ignored that the above statements were materially false and misleading deceptions when made. In truth, at the time Kain made the above statements on March 12, 2008 the value of Freddie Mac's ABS subprime and Alt-A investments were in freefall.

356. In fact, while Kain was making these materially false and misleading statements to investors, the value of Freddie Mac's ABS subprime and Alt-A investments had plunged by more than $17 billion in less than 90 days, causing the unrealized loss on Freddie Mac's AFS securities to grow to a level that was 10 times the Company's excess of the directed minimum capital standard at December 31, 2007. This enabled the Company to dramatically reduce its apparent capital needs at a critical point when it was under capital pressure and risked being out of compliance with OFHEO's capital minimums. This, of course, enabled it to increase, or at the very least maintain, the artificial inflation of Freddie Mac's securities, masking the Company's true financial condition and future business prospects.

357. Defendants financial deceptions continued when Freddie Mac reported its results for the quarter ended March 31, 2008. As noted above, on May 14, 2008, Freddie Mac announced a net loss of $151 million for the quarter ended March 31, 2008, which was much lower than the 2007 fourth quarter net loss of $2.5 billion. Freddie Mac disclosed that its improved results were due to several factors, including a change in its guarantee obligation valuation methodology, lower interest-rate related mark-to-market losses, and strong revenue growth in the guarantee business. The Company also disclosed that it had returned to timely quarterly financial reporting, remediated all remaining material weaknesses in its internal control over financial reporting and was moving ahead with its SEC registration process.

358. In response to the combination of the Company's earnings announcement and Defendants' positive statements, the price of Freddie Mac common stock rose more than 9% on very heavy trading volume, while the preferred shares gained as much as 8.6%. In truth, however, Freddie Mac's reported earnings were materially artificially inflated.

359. A fundamental precept of GAAP is that conservatism be used as a prudent reaction to uncertainty to help ensure that uncertainties and risks inherent in business situations are adequately considered and that prudent reporting be based on healthy skepticism. Financial Accounting Standards Board ("FASB") Statement of Concepts No. 2, ¶¶95, 97. Defendants violated this fundamental precept and other GAAP standards noted below in failing to timely record an other-than-temporary impairment in the value of Freddie Mac's investments that it classified as AFS securities in its financial statements. In so doing, Freddie Mac materially overstated its net income and regulatory capital surplus during the Class Period.

360. GAAP, in Statement of Financial Accounting Standards ("SFAS") No. 115, provides that investments in debt securities are to be classified in three categories and accounted for as follows:

- Debt securities that the enterprise has the positive intent and ability to hold to maturity are classified as held-to-maturity securities and reported at amortized cost.
- Debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and reported at fair value, with unrealized gains and losses included in earnings.
- Debt and equity securities not classified as either held-to-maturity securities or trading securities are classified as available-for-sale securities and reported at fair value, with unrealized gains and losses excluded from earnings and reported in a separate component of shareholders' equity (Accumulated other comprehensive income/loss).

361. Accordingly, in its 2007 annual report, Freddie Mac's financial statements for the year ended December 31, 2007 disclosed the following, in pertinent part, with respect to the accounting for its investments in mortgage-related securities:

> We classify securities as "available-for-sale'' or "trading.'' We currently do not classify any securities as "held-to-maturity'' although we may elect to do so in the future. Securities classified as available-for-sale and trading are reported at fair value with changes in fair value included in accumulated other comprehensive income (loss), net of taxes, or AOCI, net of taxes, and gains (losses) on investment activity, respectively.

362. With respect to investment securities classified as "available-for-sale," SFAS No. 115 ¶16, states, in part:

> [a]n enterprise shall determine whether a decline in fair value below the amortized cost basis is other than temporary. . . . [I]f it is ***probable*** that the investor will be unable to collect all amounts due according to the contractual terms of a debt security not impaired at acquisition, an other-than-temporary impairment shall be considered to have occurred. If the decline in fair value is judged to be other-than-temporary, the cost basis of the individual security shall be written down to fair value as a new cost basis and the amount of the write-down shall be included in earnings (that is, accounted for as a realized loss). [Footnote omitted.]

363. Accordingly, pursuant to SFAS No. 115, the investing enterprise shall determine if a decline in fair value of the investment below its amortized cost basis is "other-than-temporary." In making such determination, SFAS No. 115 provides that an other-than-temporary decline (*i.e.*, an impairment) in the value of a debt security investment is deemed to have occurred if is ***probable*** that the investor will be unable to collect all amounts due according to the contractual terms of a debt security.[39]

364. During the Class Period, Defendants knew or recklessly ignored that numerous factors were in existence which indicated that it was probable that Freddie Mac would not collect all

[39] GAAP defines probable as "likely." *See, e.g.*, SFAS No. 5

amounts due on its ABS subprime and Alt-A investments in accordance with their contractual terms. This likelihood rendered such investments impaired pursuant to SFAS No. 115.

365. The value of ABS and other similarly structured products contrived by Wall Street financiers is dependent upon the ability of the underlying mortgage borrower to repay the mortgage loan. Irrespective of the number of times that a pool of mortgages is re-sold and repackaged into new and different financial instruments, those instruments ultimately are completely dependent upon the payment performance of the borrowers in the underlying pool of mortgages. If borrowers are unable to make their mortgage payments of remittances, *i.e.*, the "credit risk," of the asset-backed security (be it RMBS or CDO) will fall in value.

366. By the end of the first quarter of 2008, Freddie Mac amassed approximately $115 billion in ABS subprime and Alt-A and other assets, an amount that equaled approximately 14% of its total assets and seven times its total shareholders' equity.

367. As noted in the chart below, during the quarter ended March 31, 2008, the unrealized losses on Freddie Mac's ABS investments exploded, from $15.1 billion at December 31, 2007 to $32.4 billion at March 31, 2008.[40] In fact, the unrealized losses associated with these investment securities increased by more than five times in the 12 month period ended March 31, 2008.

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(in millions)		
March 31, 2008				
Retained portfolio:				
Available-for-sale mortgage-related securities:				
Freddie Mac	$ 263,021	$ 3,516	$ (1,568)	$ 264,969
Fannie Mae	36,278	455	(163)	36,570
Ginnie Mae	457	21	—	478

[40] Freddie Mac disclosed this information in its Form 10-12G filed with the SEC on July 18, 2008.

Sub-prime	93,023	2	(17,089)	75,936
Alt-A and other	49,840	11	(10,976)	38,875
Commercial mortgage-backed securities	64,616	160	(1,719)	63,057
Manufactured housing	1,109	137	(22)	1,224
Mortgage revenue bonds	14,103	66	(813)	13,356
Total available-for-sale mortgage-related securities	$ 522,447	$ 4,368	$ (32,350)	$ 494,465
December 31, 2007				
Retained portfolio:				
Available-for-sale mortgage-related securities:				
Freddie Mac	$ 346,569	$ 2,981	$ (2,583)	$ 346,967
Fannie Mae	45,688	513	(344)	45,857
Ginnie Mae	545	19	(2)	562
Sub-prime	101,278	12	(8,584)	92,706
Alt-A and other	51,456	15	(2,543)	48,928
Commercial mortgage-backed securities	64,965	515	(681)	64,799
Manufactured housing	1,149	131	(12)	1,268
Mortgage revenue bonds	14,783	146	(351)	14,578
Total available-for-sale mortgage-related securities	$ 626,433	$ 4,332	$ (15,100)	$ 615,665
March 31, 2007				
Retained portfolio:				
Available-for-sale mortgage-related securities:				
Freddie Mac	$ 352,339	$ 1,728	$ (4,551)	$ 349,516
Fannie Mae	43,349	392	(501)	43,240
Ginnie Mae	664	18	(4)	678
Sub-prime	120,985	51	(74)	120,962
Alt-A and other	56,764	65	(267)	56,562
Commercial mortgage-backed securities	50,966	234	(694)	50,506
Manufactured housing	1,143	167	—	1,310
Mortgage revenue bonds	13,781	296	(42)	14,035
Total available-for-sale mortgage-related securities	$ 639,991	$ 2,951	$ (6,133)	$ 636,809

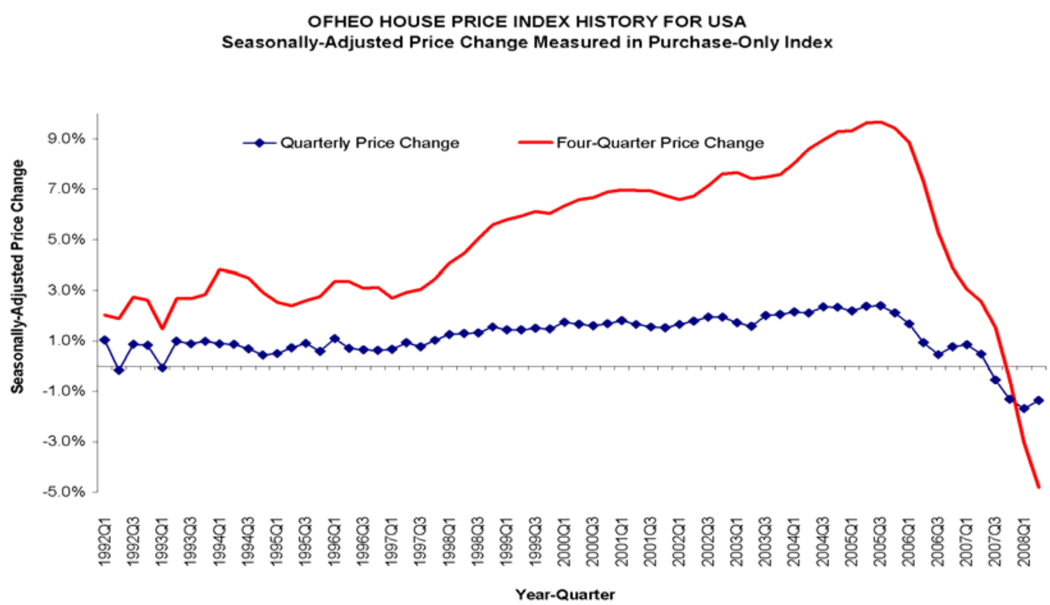
368. Pursuant to the above chart, $28.1 billion, or 87% of such unrealized losses at March 31, 2008, were attributable to Freddie Mac's subprime and Alt-A and other securities. The chart above also acknowledges that in the 90 day period ending March 31, 2008, the unrealized losses on Freddie Mac's subprime and Alt-A and other investments increased by approximately 100% and 332%, respectively.

369. The massive diminution in the value of Freddie Mac's subprime and Alt-A investments during the March 31, 2008 quarter was a free market bullhorn in the ears of Defendants telling them, if they did not already know, that it was not at all probable that Freddie Mac would collect all amounts due on its subprime and Alt-A ABS investments in accordance with their contractual terms, thereby rendering such investments impaired pursuant to SFAS No. 115 no later than March 31, 2008.

370. As Defendants knew or recklessly ignored, increasing defaults and delinquencies on subprime and Alt-A mortgage loans caused the values of Freddie Mac's subprime and Alt-A securities to decline precipitously during the Class Period. This increase in the rate of defaults and delinquencies of U.S. mortgage loans was another red flag waving in the faces of Defendants advising them that it was not at all probable that Freddie Mac would collect all amounts due on its ABS subprime and Alt-A investments in accordance with their contractual terms and that the value of such investments was impaired pursuant to SFAS No. 115 no later than March 31, 2008.

371. Industry experts use three main indicators to assess the current state of, and future prospects of, the mortgage market: (i) the Housing Price Index, which measures home prices; (ii) interest rates; and (iii) delinquency rates, which monitor the percentage of mortgagors who default on their mortgage obligations.

372. As noted in the following chart, U.S. housing prices collapsed prior to and during the Class Period:



373. As residential housing prices fell in the U.S., many of the initial "teaser" mortgage interest rates offered to subprime and Alt-A mortgage borrowers had started to expire, causing their mortgage payments to balloon as rates reset to then market levels.

374. The combination of decreasing home values and increasing adjustable-rate-mortgage ("ARM") interest rates resulted in increased rates of residential mortgage delinquencies and defaults for both subprime and Alt-A borrowers:

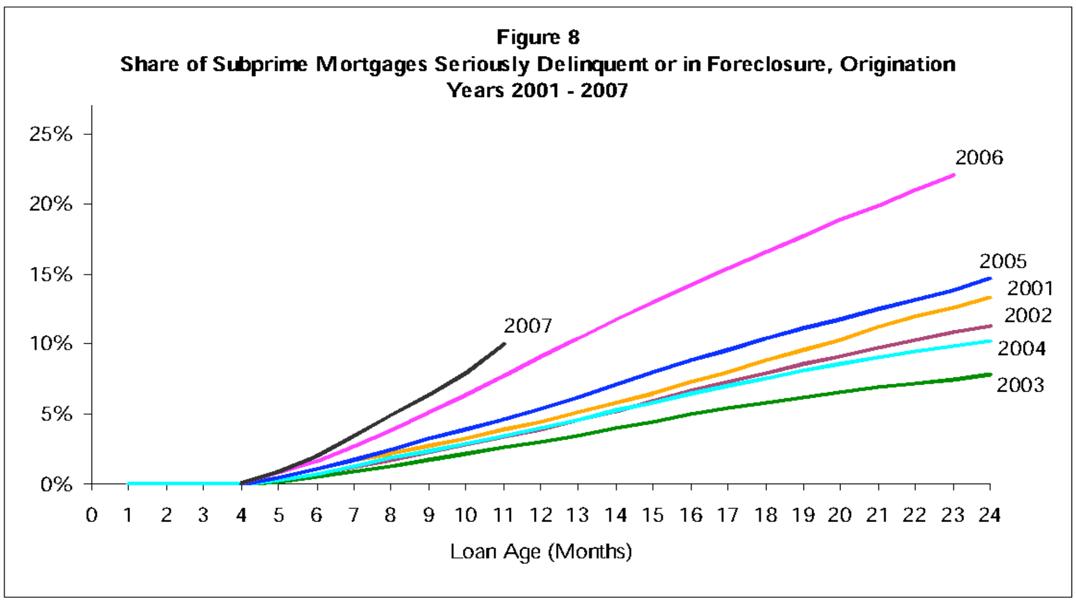
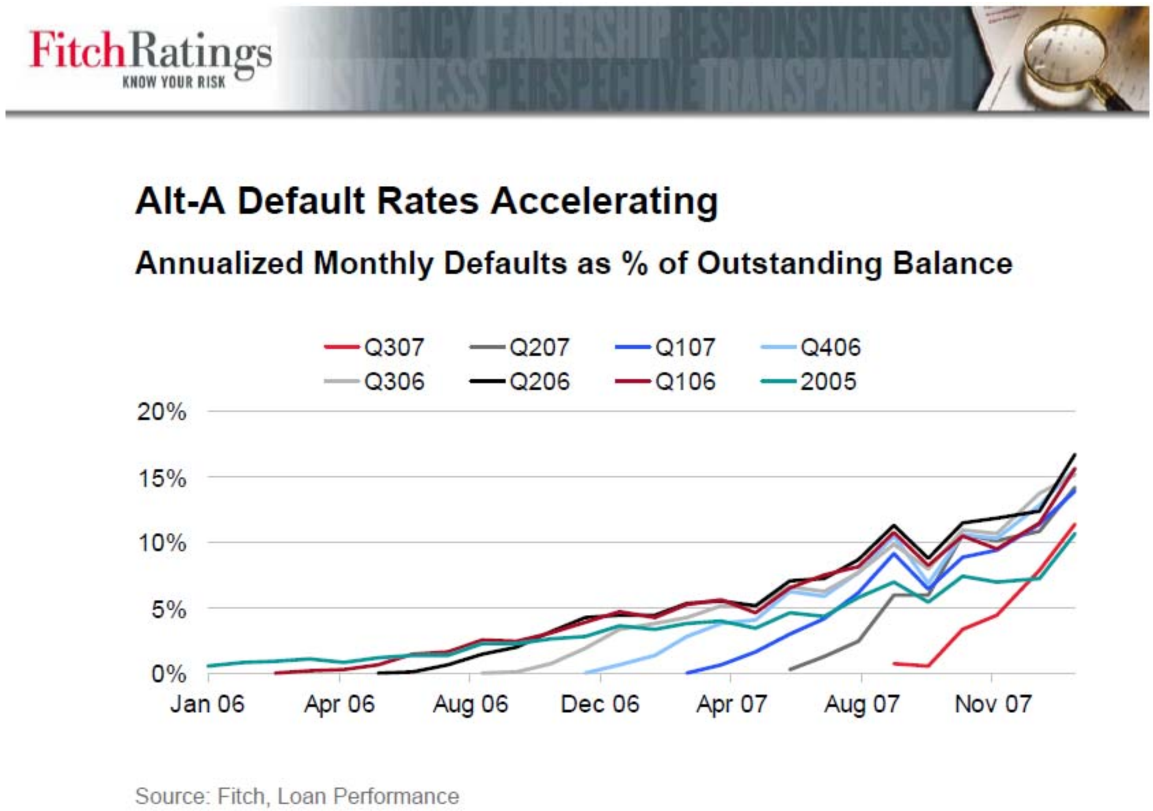


Figure 8
Share of Subprime Mortgages Seriously Delinquent or in Foreclosure, Origination Years 2001 - 2007

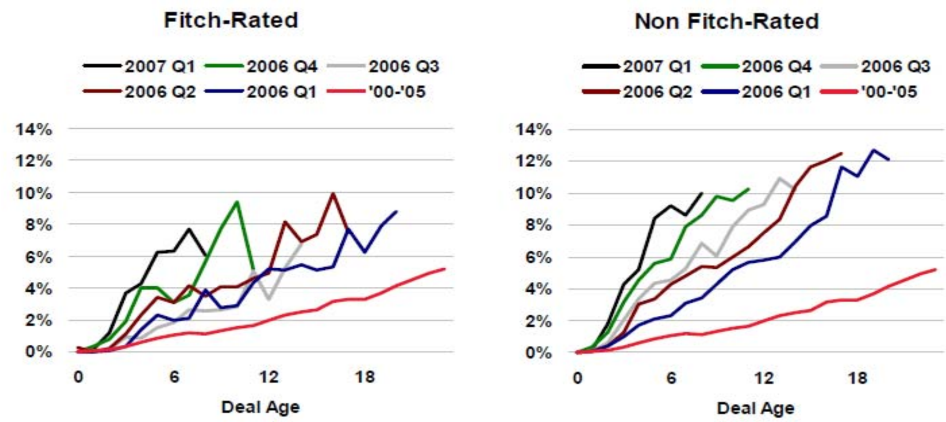
Note: Reflects 30-year fixed-rate and 2/28 hybrid adjustable-rate mortgages with borrower credit scores at origination of less than 660.
Source: OFHEO based on data from First American LoanPerformance



375. Faced with new, higher mortgage payments, little refinancing options and declining home values that wiped out what little equity they had in their homes, millions of U.S. mortgagees who over-extended themselves by purchasing homes that they could not afford with low, teaser interest rates or other exotic mortgage terms began to default on their mortgages:

FitchRatings
KNOW YOUR RISK

ARM Performance Is Worse Than Fixed
Annualized Monthly Default Rates

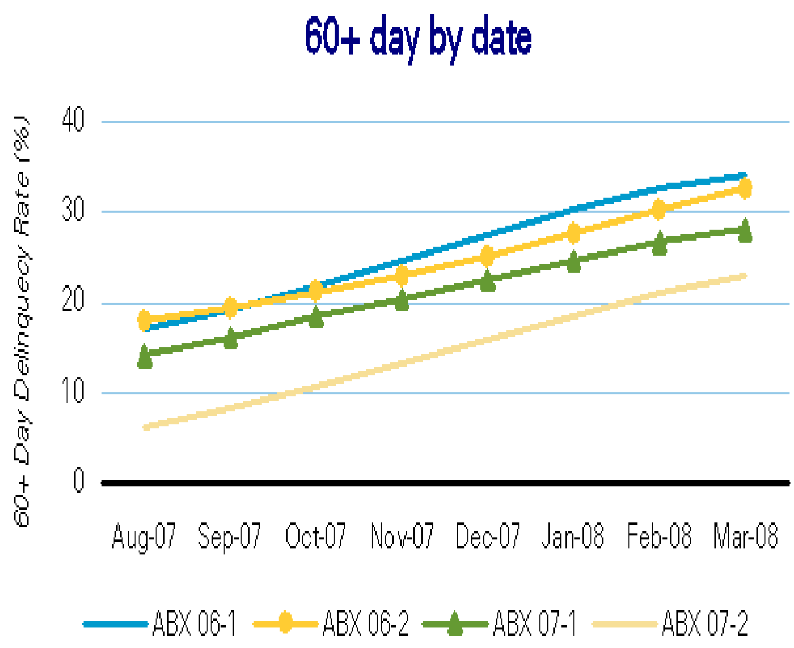


Source: Fitch, Loan Performance

376. These increases in the delinquency and default rates on subprime and Alt-A mortgage loans eviscerated the value of Freddie Mac's subprime and Alt-A securities prior to and during the Class Period, which is evidenced by the trading platforms that monitored subprime securities, including the ABX Index. The ABX Index measures the cost of purchasing "protection" for subprime RMBS and CDOs. This "protection," in the form of a credit default swap ("CDS"), is akin to purchasing insurance on the value of the security.

377. The ABX Index tracks the cost of buying and selling CDS protection for selected RMBS tranches. Each of the Index's RMBS tranches has a different rating, from AAA to BBB-, and is considered to be representative of other RMBS product tranches backed by subprime collateral with the same rating. The components of the ABX Index are classified by vintage (*i.e.*, the year when the underlying subprime mortgage loans were issued). For example, ABX Index 07-1 references subprime mortgage-backed RMBS tranches for mortgage loans originated in the second half of 2006. Likewise, ABX Index 07-2 references mortgage-backed RMBS tranches for mortgage loans that were originated in the first half of 2007.

378. As noted in the table below, prior and during the Class Period, the severe delinquency rates (*i.e.*, more than 60 days past due) of subprime ABX indices increased significantly:



Source: Deutsche Bank, Loan Performance, Intex Solutions

379. The significant increases in the severe delinquency rates of the ABX Indices was a clear sign to Defendants that it was not at all probable that Freddie Mac would collect all amounts due on its ABS subprime and Alt-A investments in accordance with their contractual terms, thereby rendering such investments impaired pursuant to SFAS No. 115 no later than March 31, 2008.

380. Indeed, Defendants ***knew*** that the severe delinquency rates associated with the subprime investment securities held by Freddie Mac were highly elevated during the Class Period. In fact, on March 12, 2008, at the Company's 2008 Investor/Analyst Conference, Defendants disclosed that the 2005 and 2006 vintage subprime investment securities held by Freddie Mac were experiencing severe delinquency rates of more than ***25%***. Indeed, the delinquency rates of Freddie

Mac's non-agency mortgage-related securities back by subprime and Alt-A loans at March 31, 2008 was 27% and 10%, respectively.

381. This fact was not lost on Defendants. For example, at Freddie Mac's 2008 Investor/Analyst Conference on March 12, 2008, Defendants made the following statements:

> Cook:
>
> ***Despite the continued deterioration of the housing market and increases in non-prime delinquencies***, we remain comfortable with our risk position on these assets. Remember, to the end of 2007, we have recorded no credit related impairments on these funds, and we have no CDO exposure. [Emphasis added.]
>
> Kain:
>
> So, in closing, ***despite the continued deterioration of the housing market and increases in non-prime delinquencies*** for the reasons discussed, we remain comfortable with our exposure to these assets. [Emphasis added.]

382. In violation of SFAS No. 115, Defendants failed to record an other-than-temporary impairment in the value of Freddie Mac's AFS subprime and Alt-A securities when they ***knew*** that such securities were experiencing high levels of delinquencies and defaults, which indicated it was probable that Freddie Mac would not collect all amounts due on such investments in accordance with their contractual terms.

383. In addition to the guidance set forth in SFAS No. 115, the Staff of the FASB, in November 2005, issued its interpretation about the meaning of "other-than-temporary" and its application associated with the impairment of certain investments, like Freddie Mac's AFS subprime and Alt-A investments. Such interpretation, set forth in FASB Staff Position Nos. FAS 115-1 and FAS 124-1, provides that:[41]

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[41] Like SFASs, FASB Staff Positions are among the highest authority of GAAP. SFAS No. 162.

(1) An assessment of impairment is to occur during each interim period *(i.e.,* quarterly);

(2) Impairment shall be assessed at the individual security level;

(3) An investment is impaired if its fair value is less than its cost;

(4) If the fair value of the investment is less than cost, the impairment is either temporary or other-than-temporary. Other-than-temporary does not mean permanent; and

(5) An investor shall apply other GAAP guidance in determining whether an impairment is other-than-temporary, such as SFAS No. 115, Staff Accounting Bulletin ("SAB") 59, Accounting Principles Board Opinion No. 18 and Emerging Issues Task Force ("EITF") Issue No. 99-20.

384. As an initial matter with respect to the guidance set forth in FAS 115-1 and FAS 124-1, at least ***$10 billion*** of the losses on Freddie Mac's AFS subprime and Alt-A securities were not "temporary" and were required to be charged against the Company's net income during the quarter ended March 31, 2008. In fact, certain of Freddie Mac's AFS subprime and Alt-A investments at March 31, 2008 had been in loss position ***for at least a year and the amount of the losses on such securities were in excess of $10.5 billion.***

385. Under GAAP, a period of 12 months or longer is generally considered to be "long-term." *See, e.g.*, Accounting Research Bulletin No. 43. Nonetheless, in violation of GAAP, Defendants knowingly or recklessly failed to cause other-than-temporary losses on the Company's AFS subprime and Alt-A securities to be written off to avoid having to include them in Freddie Mac's net income and the determination of its regulatory capital sufficiency.

386. The staff of the SEC has long cautioned its registrants not to delay the recognition of an other-than-temporary impairment in the value of its investments. For example, the SEC's SAB No. 59 provides that "other-than-temporary" does not mean "permanent" and that factors such as the following are to be considered in evaluating where an impairment is to be recognized: (1) the length of the time and the extent to which the market value has been less than cost; (2) the financial condition and near-term prospects of the issuer; and (3) the intent and ability of the holder to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value.

387. Similarly, in a 2001 speech entitled *Transparent Financial Reporting and Disclosures*, Lynn Turner, then Chief Accountant of the SEC, stated, in part, the following with respect to the meaning of other-than-temporary:

> In several Accounting and Auditing Enforcement Releases ("AAERs") (see, for example, *In the Matter of Fleet/Norstar*, AAER No. 309; *In the Matter of Excel Bancorp, Inc.*, AAER No. 316; *In the Matter of Abington Bancorp, Inc.*, AAER No. 370; and *In the Matter of Presidential Life Corporation*, AAER No. 443), the Commission has taken action in instances when other than temporary declines in value were not reported in a timely and appropriate fashion.
>
> In these releases, the Commission noted a registrant's assessment of the realizable value of a marketable security should begin with its contemporaneous market price because that price reflects the market's most recent evaluation of the total mix of available information. These releases also state that objective evidence is required to support a realizable value in excess of a contemporaneous market price. Such information may include the issuer's financial performance (including such factors as earnings trends, dividend payments, asset quality, and specific events), the near term prospects of the issuer, the financial condition and prospects of the issuer's region and industry, and the registrant's investment intent.
>
> Additionally, the releases state that the Commission expects registrants will employ a systematic methodology that includes documentation of the factors considered. Such methodology should ensure that all available evidence concerning declines in market values below cost will be identified and evaluated in a disciplined manner by responsible personnel. Auditors are reminded of the need to closely examine the documentation concerning their clients' determinations of other than temporary declines in market values.

> The staff has asked registrants to demonstrate, with objective evidence, why they believe that a write down in realizable value is not required for those securities that have experienced declines in value that appear to be other than temporary.

388. Concerning the length of time and the extent to which the market value of Freddie Mac's AFS securities had been less than cost, by March 31, 2008, the magnitude of the losses on Freddie Mac's investments in subprime and Alt-A instruments was a staggering $28.1 billion. These losses respectively represented a more than an 18% and 22% decline from Freddie Mac's cost in its subprime and Alt-A investments. In addition and as noted above, more than $10.5 billion of these losses had been in existence for more than a year.

389. Concerning the financial condition and near-term prospects of Freddie Mac's subprime and Alt-A securities, by almost every publicly available account, the prospects for a turnaround in the U.S. mortgage market during early 2008 was unforeseeable. Housing prices were in continuous decline and mortgage delinquencies and defaults were escalating.

390. Accordingly, by any interpretation of other-than-temporary set forth in GAAP, Freddie Mac's financial reporting during the Class Period was materially false and misleading and in violation of GAAP because the Company failed to timely write off other-than-temporary losses on its subprime and Alt-A investments during the Class Period. Indeed, this impropriety, as Defendants knew or recklessly ignored, overstated Freddie Mac's net income and core capital in determining its regulatory capital sufficiency by at least $10 billion at March 31, 2008.

391. As noted herein, during the Class Period, Defendants trumpeted the purported AAA ratings of Freddie Mac's subprime investments, in part, to deceptively support their highly unreasonable failure to record an other-than-temporary impairment in the value of such securities.

392. In truth, between December 31, 2007 and February 25, 2008, the credit ratings associated with more than $16 billion of Freddie Mac's AAA securities backed by subprime loans, or more than 15% of such portfolio, were downgraded below AAA by at least one nationally

recognized rating agency. Accordingly, in less than 60 days, more than 17% of Freddie Mac's AAA subprime investments were downgraded below AAA.

393. This was yet another red flag to Defendants that Freddie Mac's investment securities had suffered at least a $10 billion other-than-temporary impairment by no later than March 31, 2008, ***especially when the rating agencies were being politically and publically attacked, both prior to and during the Class Period, for failing to timely downgrade subprime and Alt-A securities***.

394. For example, on September 26, 2007, *National Public Radio* reported:

> Lawmakers will grill executives from credit-rating agencies for their role in the subprime mortgage crisis at today's Senate committee hearing. ***Critics say firms like Moody's and Standard & Poor's failed to see the risk. They say rating agencies should have downgraded the bonds backed by risky home loans much earlier.***
>
> The firms made their first downgrade last July, at least two months after defaults on subprime loans started rising. Still, there's probably not much Congress can do to overhaul the rating system - beyond finger pointing, that is. There's even less it can do to restore confidence in the debt products that have exploded on Wall Street in recent years. [Emphasis added.]

395. On February 14, 2008, *Economist.com* reported, in part:

> All three agency heads placed much of the blame for the economic downturn on the broken housing market and its ripple effect on the credit markets. ***Members of Congress hold the credit rating agencies responsible for not acting quickly enough to downgrade mortgage-backed securities that in retrospect were, according to Sen. Richard Shelby, "grossly underestimated."*** [Emphasis added.]

396. On April 22, 2008, the *Associated Press* reported, in part:

> The industry, dominated by Standard & Poor's, Moody's Investors Service and Fitch Ratings, has been roundly criticized for failing to accurately assess and warn investors about the risks that mortgage investments posed to financial markets.
>
> ***Senators suggested Tuesday that the government should suspend credit rating agencies' government licenses*** if they consistently give inaccurate ratings. Sen. Richard Shelby, the committee's senior Republican, compared the rating agencies to doctors. "***If they're incompetent, they jerk their licenses,"*** Shelby said, adding that by being ***"consistently wrong"*** on mortgage investment risks, ***"they have contributed greatly to the financial debacle we have today."*** [Emphasis added.]

397. On April 27, 2008, the *Motley Fool*, reported, in part:

> Again, ***the ratings agencies have lost all credibility in this crisis***... they're supposed to gauge risk... but apparently they retained full confidence in these instruments despite the massive collapse in the market for the sub-prime securities and the worst housing downturn in decades. Nice job, Moody's! ***Investors would be wise to question the ratings on everything at this stage, as the ratings agencies have proven that they are either entirely inept or are unwilling to inform the public of risks until they absolutely have to***.
>
> Moody's Begins Downgrading AAA-Rated Alt-A RMBS to Junk
>
> Published: April 24, 2008
>
> Moody's Investors Service issued more Alt-A downgrades on Thursday morning, this time taking a heavy hand to 32 different Aaa-rated tranches from 10 different Alt-A deals. Many of the downgrades even pushed former Aaa's into non-investment grade categories - a stunning descent for top-rated Alt-A mortgage bonds that underscores two key points.
>
> First, defaults are obviously accelerating. Second, many Alt-A deals were issued with less in the way of overcollateralization - which, in plain English, means that these deals will start to see downgrades sooner, compared to the relative stress that a typical subprime RMBS deal can withstand before the hits start coming at the Aaa level.
>
> The rating agency placed an additional 254 Aaa-rated Alt-A classes on negative ratings watch Wednesday. [Emphasis added.]

398. On May 16, 2008, *Dow Jones Factiva*, reported, in part:

> ***[Credit rating] agencies are again in the firing line over the subprime debacle for having handed out investment grade ratings to debt-laden assets later regarded as "toxic waste".*** [Senator] Sarbanes said politicians were considering how to make those agencies more accountable. "They're being looked at in Congress." [Emphasis added.]

399. On information and belief, Defendants used the Company's purported credit risk mitigation strategies to deceptively support their highly unreasonable failure to record an other-than-temporary impairment in the value of Freddie Mac's investments in subprime and Alt-A instruments during the Class Period. In truth, these strategies, which included certain underwriting and quality

control standards and, so called, "credit enhancements," were not operating effectively, as Defendants knew or recklessly ignored.

400. On information and belief, Freddie Mac creates and maintains underwriting and quality control standards that it provides to mortgage originators, who in turn, represent to Freddie Mac that the mortgage loans they originate, comply with such standards. Prior to and during the Class Period, these underwriting standards were to be utilized by mortgage originators to evaluate the borrower's credit standing, repayment ability and the value and adequacy of the mortgaged property used as collateral. As Defendants knew or recklessly ignored, prior to and during the Class Period mortgage originators engaged in pervasive violations of such standards.

401. On information and belief, originators of the mortgages implemented policies designed to extend mortgages to borrowers regardless of whether they were able to meet their obligations under the mortgage, such as:

- Coaching borrowers to misstate their income on loan applications to qualify for mortgage loans under the underwriters' underwriting standards, including directing applicants to no-documentation ("no-doc") loan programs when their income was insufficient to qualify for full documentation loan programs;
- Steering borrowers to loans that exceeded their borrowing capacity;
- Encouraging borrowers to borrow more than they could afford by suggesting No Income No Assets ("NINA") and Stated Income Stated Assets ("SISA") loans when they could not qualify for full documentation loans based on their actual incomes;
- Approving borrowers based on "teaser rates" for loans despite knowing that the borrower would not be able to afford the "fully indexed rate" when the loan rate adjusted; and
- Allowing non-qualifying borrowers to be approved for loans under exceptions to the underwriters' underwriting standards based on so-called "compensating factors" without requiring documentation for such compensating factors.

402. On information and belief, in fact, mortgage originators had become so aggressive in approving and funding the mortgage loans, that many of the mortgage loans were made to

borrowers who had either not submitted or had altered the required mortgage loan documentation. In many instances, borrowers who were actually required to submit stated income applications would include income levels which were routinely inflated to extreme levels in order to get the mortgage loans approved and funded. Inflation of stated income was so rampant, that a study cited by Mortgage Asset Research Institute found that ***almost all*** stated-income loans exaggerated the borrower's actual income by 5 percent or more, ***and more than half increased the amount by more than 50 percent***.

403. As a result, the underwriting and quality control standards that Freddie Mac relied upon to mitigate its credit risk were rendered ineffective, as Defendants knew or recklessly ignored.

404. Indeed, in 2005, a white paper issued by the Federal Financial Institutions Examination Council ("FFIEC") in Washington, D.C. reported that as many as 10% of all mortgage loan applications annually in the U.S. residential real estate market involved "material misrepresentation."

405. In October 2005, *USA Today* reported: "As the U.S. housing market hits record highs, mortgage fraud appears to be rising from California to Florida." The story quotes the author of a report on mortgage fraud, who noted that "[f]raud is costing the industry at least tens of millions of dollars a year."

406. By early 2006, HSBC Holdings PLC ("HSBC"), one of the country's largest lenders, was seeing indications that delinquencies were going to be worse than expected. In August 2005, HSBC issued a memo to companies from which it was buying loans. The paper called "Threads of Early Payment Default" reported that delinquencies were rising. HSBC said mortgage lenders had seen "a wealth of surprising data" on loans originated in 2005, including "surges" in 60-day-past-due delinquencies, particularly on "borrower-friendly" second lien loans, and "heightened

fraud incidents." When borrowers didn't have to verify their incomes, the report said they were overstating them, and they bolstered their false claims by overstating their job positions. HSBC recommended that originators verify employment by phoning the human resources departments and asking questions such as: "How many years has John worked there?" and "What is his title?"

407. On information and belief, these problematic practices, which had a material adverse effect on primary mortgage insurance companies that Freddie Mac utilized to protect its mortgage portfolio, continued into 2007.

408. On information and belief, in addition to deceptively touting the purported AAA ratings of Freddie Mac's ABS investments that were backed by subprime and Alt-A loans, Defendants mislead investors by representing that "credit enhancements," were effectively mitigating Freddie Mac's mortgage credit risk. During the Class Period, Defendants falsely and misleadingly used such purported credit enhancements as another façade to deceptively support their highly unreasonable failure to record an other-than-temporary impairment in the value of Freddie Mac's investments in subprime and Alt-A securities.

409. On information and belief, during the Class Period, primary mortgage insurance was the prevalent form of credit enhancement utilized by Freddie Mac to protect its mortgage portfolio. In essence, primary mortgage insurance transfers varying portions of the credit risk associated with a mortgage to a third-party insurer. Accordingly, the utility of primary mortgage insurance is only as good as the performance and solvency of the mortgage insurance company insuring a particular mortgage.

410. On information and belief, as of March 31, 2008, Freddie Mac's top four mortgage insurers were: MGIC, Radian Guaranty Inc. ("Radian"), Genworth Mortgage Insurance Corporation and PMI Mortgage Insurance Co. ("PMI"). The rampant mortgage origination fraud and lax credit

lending standards prior to the Class Period had a material adverse effect on mortgage insurers that insured the Freddie Mac's mortgage portfolio. Freddie Mac also required that, in order for a mortgage insurer to be included on its LP automated underwriting system, it had to agree to LP's decision. This eliminated an independent review by the mortgage insurer and compounded the rescission problems noted earlier. As a result, Defendants' positive statements about Freddie Mac's "credit enhancements" were yet an another deception foisted upon investors to support their high unreasonable for not recording an other-than-temporary impairment in the value of Freddie Mac's investments in subprime and Alt-A securities.

411. For example, on July 31, 2007, Fitch Ratings ("Fitch") downgraded the insurer financial strength ("IFS") rating of MGIC to AA from AA+ and placed the "A" long-term debt ratings of Radian and the 'AA' IFS ratings of all of its mortgage and financial guaranty subsidiaries on Rating Watch Negative. On February 26, 2008, Fitch placed MGIC on Negative Rating Watch and said if MGIC did not raise additional capital to support its franchise, it would downgrade MGIC's rating to 'AA-'. On April 9, 2008, S&P downgraded MGIC from AA- to A with a Negative Outlook. In response, Freddie Mac announced that MGIC has 90 days to file a plan detailing how it was going to restore its AA rating.

412. As a result of its worsening financial strength, MGIC stock declined from a high of approximately $65 share in June 2007 to approximately $10 per share in March 2008.

413. Like MGIC, Freddie Mac's other primary mortgage insurers experienced extreme financial distress prior and during the Class Period. As a result, the price of Radian's and PMI's common stock plummeted from approximately $50 per share in 2007 to approximately $5 per share in March 2008.

414. Accordingly, the financial strength of the primary mortgage insurers that Freddie Mac utilized to credit enhance and mitigate the credit risk of mortgage loans had been severely compromised. Nonetheless, Defendants falsely and misleadingly used such purported credit enhancements as another façade to deceptively support their highly unreasonable failure to record an other-than-temporary impairment in the value of Freddie Mac's investments in subprime and Alt-A securities.

415. According to a former Freddie Mac Controller for the Retained Portfolio, any AFS securities that Freddie Mac's traders contemplated selling for a loss after the end of the quarter but before the quarterly results are released need to be accounted for as an other-than-temporary impairment. The is due to the fact that Freddie Mac does not have the intent to retain its investment for a period of time sufficient to allow for any anticipated recovery in market value. Accordingly, if traders knew they were going to sell holdings in January 2008 then Freddie Mac has to take the impairment of the expected loss during the December 31, 2007 quarter. The Freddie Mac Controller for the Retained Portfolio stated that there were "hundreds of millions of dollars of bonds" sold in January2008, and they were priced in the low "80's or high 70's", with 100 being the original purchase price of the securities. Nonetheless in violation of GAAP and its accounting policies, Freddie Mac failed to record the impairment of such securities during the quarter ended December 31, 2007

416. While Defendants were resolute about not recording an impairment in the value of Freddie Mac's subprime and Alt-A assets during the Class Period, other financial institutions were not. Indeed the numerous announcements that financial institutions had written-off their subprime related assets was yet another red flag that put Defendants on notice that the subprime-backed

securities on Freddie Mac's books suffered an other-than-temporary decline in value no later than March 31, 2008.

417. For example, in January 2007, National City Corporation announced that its subprime mortgage originator subsidiary, First Franklin, experienced losses in 4Q 2006 totaling $172 million as the result of the sale and write-down of subprime loans held for sale. (*National City Reports Fourth Quarter and Full Year 2006 Results*, PR Newswire, Jan. 23, 2007).

418. In February 2007, HSBC announced that it would take $10.56 billion in impairments on its subprime loan portfolio for 4Q 2006.

419. In April 2007, New Century TRS Holdings filed for Chapter 11 and in June 2007, the market learned that two hedge funds run by Bear Stearns would be forced to liquidate some of its mortgage-backed securities portfolio in order to meet margin calls.

420. In October 2007, Merrill announced that it would write-down its ABS CDOs by $12.4 billion.

421. Also in October 2007, Swiss bank UBS AG ("UBS") wrote-down $4.4 billion in subprime related RMBS and CDOs. This was followed by a $10 billion in subprime related RMBS and CDO write down on December 10, 2007. On January 30, 2008, UBS announced that it had written-down an additional $4 billion as at December 31, 2007.

422. During the three months ended March 31, 2008, American International Group, Inc. ("AIG") recorded an other-than-temporary impairment charge of $5.6 billion that was "primarily related to the significant disruption in the residential mortgage and credit markets." In its Form 10-Q for the quarter ended March 31, 2008, AIG disclosed:

> In light of the recent significant disruption in the U.S. residential mortgage and credit markets, AIG has recognized an other-than-temporary impairment charge (severity loss) of $4.1 billion in the first three months of 2008, primarily with respect to certain RMBS and other structured securities. ***Even while retaining their***

> ***investment grade ratings, such securities were priced at a significant discount to cost. Notwithstanding AIG's intent and ability to hold such securities indefinitely, and despite structures that indicate that a substantial amount of the securities should continue to perform in accordance with original terms, AIG concluded that it could not reasonably assert that the recovery period would be temporary***. [Emphasis added.]

423. Confronted with a distinctively unique financial crisis and to countless red flags indicating that the value of Freddie Mac's ABS subprime and Alt-A mortgages securities that it classified as AFS investments in its Class Period financial statements had suffered a material other-than-temporary decline in the value, Defendants concocted a series of deceptive financial analyses and tests to support their position that such assets need not be charged against Freddie Mac's net income or included in the determination of its capital adequacy.

424. Such deceptive efforts by Defendants, and their collective, determined failure to see the obvious, constitute nothing less than intentional fraud or conscious misbehavior. Indeed, Defendants made these highly unreasonable failures to record in a desperate attempt to preserve Freddie Mac's scant financial capital and solvency.

425. After Freddie Mac announced its earnings for the quarter ended June 30, 2008, its common stock declined precipitously as the market began to fully appreciate the extent of Freddie Mac's capital inadequacy. During the June 2008 quarter, the Company announced a $826 million charge associated with Freddie Mac's mortgage-related investments backed by subprime and Alt-A loans:

> During the second quarter of 2008 and 2007, we recorded other-than-temporary impairments related to investments in available-for-sale securities of $1.0 billion and $294 million, respectively. Of the impairments recognized during the second quarter of 2008, $826 million related to non-agency securities backed by subprime or Alt-A and other loans, primarily due to recent deterioration in the performance of the collateral underlying these securities. The primary contributors to the deteriorating performance were negative delinquency trends that continued, and in several cases accelerated. Our securities backed by second lien subprime loans suffered a pronounced decline in credit enhancement levels. Also contributing to these impairments were credit enhancements related to monoline bond insurance provided

> by one monoline on individual securities in an unrealized loss position where we have determined that it is both probable a principal and interest shortfall will occur on the insured securities and that in such a case there is substantial uncertainty surrounding the insurer's ability to pay all future claims.

426. After the end of the Class Period, when Defendants were no longer able to mask Freddie Mac's capital inadequacy and it was forced to operate under the direction of FHFA as its conservator, Freddie Mac announced it recorded ***$22.5 billion*** in other-than-temporary impairments on it AFS mortgage-related securities backed by subprime and Alt-A mortgage loans, of which $8.9 billion was recorded in the third quarter of 2008:

> Of our $204.5 billion in non-agency mortgage-related securities in our available-for-sale portfolio at September 30, 2008, we have identified securities backed by subprime and Alt-A and other loans, including MTA loans, with $21.7 billion of unpaid principal balance that are probable of incurring a contractual principal or interest loss due to significant recent and sustained deterioration in the performance of the underlying collateral of these securities, considerably more pessimistic expectations around future performance due to the unprecedented deterioration in economic conditions since the second quarter, and decreased confidence in the credit enhancements related to two primary monoline insurers where we have determined that it is both probable a principal and interest shortfall will occur on the insured securities and that in such a case, there is substantial uncertainty surrounding the insurer's ability to pay all future claims. As such, we recognized impairment losses on these securities of $8.9 billion during the third quarter of 2008, which were determined to be other-than-temporary.

427. Indeed, the very same factors that caused Freddie Mac to recognize an other-than-temporary impairment in the value of its disclosed AFS mortgage-related securities backed by subprime and Alt-A mortgage loans after the end of the Class Period were in existence prior to and during the Class Period.

428. Moreover, after the end of the Class Period, Freddie Mac admitted material control deficiencies associated with its determination of other-than-temporary impairments exist, and that these deficiencies have not been remediated as of ***March 31, 2009***:

> As a result of management's evaluation, our Interim Chief Executive Officer concluded that our disclosure controls and procedures ***were not effective*** as of March 31, 2009, at a reasonable level of assurance, for the following reasons:

- Our disclosure controls and procedures did not adequately ensure the accumulation and communication to management of information known to FHFA that is needed to meet our disclosure obligations under the federal securities laws;

- ***we continue to have a material weakness in the design and documentation of controls over our counterparty credit risk analysis that impacts our significant judgments and estimates*** for single-family loan loss reserves and ***other-than-temporary impairments of available-for-sale securities;*** and

- ***we continue to have a material weakness in the controls over development of our securities impairment model used in our determination of other-than-temporary impairments of available-for-sale securities***.

We have not been able to update our disclosure controls and procedures to provide reasonable assurance that information known by FHFA on an ongoing basis is communicated from FHFA to Freddie Mac's management in a manner that allows for timely decisions regarding our required disclosure. Based on discussions with FHFA and the structural nature of this continuing weakness, it is likely that we will not remediate this weakness in our disclosure controls and procedures while we are under conservatorship.

2. Freddie Mac's Other Violations of GAAP

429. In addition to the violations of GAAP noted above, Defendants also improperly failed for Freddie Mac's deferred tax assets during the Class Period. Here again, Defendants' improper accounting for Freddie Mac's deferred tax assets was motivated by their desperate attempt to avoid recognizing losses that would have wiped out its financial capital.

430. Pursuant to GAAP, an entity's probable future tax benefits are to be reported in its financial statements as deferred tax assets. GAAP, in SFAS No. 109, provides that deferred tax assets must be realizable; that it, the entity's anticipated taxable income, should be sufficient to support the value the deferred tax asset. When it is "more likely than not" that some portion or all of the tax deferred benefits will not be realized due to an uncertainty about an entity's future taxable income, GAAP requires that deferred tax assets be written off against earnings via a reserve account called a valuation allowance.

431. As of March 31, 2008, Freddie Mac's deferred tax asset had grown to $19 billion, up from $12.2 billion at December 31, 2007, ***or more than 55% in just 90 days***. At March 31, 2008 Freddie Mac's deferred tax assets exceeded the Company's entire net worth on that date by close to 20%.

432. In addition, Freddie Mac's reported core capital at March 31, 2008 was $38.32 billion (excluding the at least $10 billion overstatement in its core capital due to the Company's improper failure to record an other-than-temporary impairment in the value of its AFS securities for the reasons noted in detail above). Accordingly, nearly ***50%*** of the Company's core capital at March 31, 2008 was attributable to the Company's deferred tax asset. Had Freddie Mac established a valuation allowance to account for the amount of its deferred tax benefit at March 31, 2008, it would have violated its directed minimum capital standard of $6 billion by ***$13 billion***.

433. Deferred tax assets represent tax benefits that a Company has accumulated over time to offset future profits. Accordingly, the determination about whether it is "more likely than not" that some portion or all of the tax deferred benefits will be realized, is based on an assessment by management that the Company will likely generate sufficient income in the foreseeable future to realize the entire amount of its deferred tax asset.

434. In making such a determination, management must consider all positive and negative facts, including the Company's operating results history and forecasted future taxable income. "Forming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence such as cumulative losses in recent years." SFAS No. 109, ¶23.

435. Despite all of the negative evidence concerning Freddie Mac's operations and its expected losses, Defendants, as of at least March 31, 2008, knowingly or recklessly failed to record a

valuation allowance and, accordingly, a concomitant charge against earnings, associated with its huge deferred tax asset.

436. Indeed, in order for Freddie Mac to realize the total benefits from its deferred tax assets as of March 31, 2008, management would have needed to forecast more profits than Freddie Mac had reported during its prior five years. To the contrary, management expected just the opposite.

437. In fact, on December 12, 2007, Defendant Syron stated "[i]f our expectations are realized, we would expect that our total future credit losses from our current book of business will total 10[billion] to $12 billion." Accordingly, during the Class Period, Defendants had no reasonable basis for concluding it was "more likely than not" that some portion or all of the tax deferred benefits would not be realized due to the uncertainty associated with Freddie Mac's future taxable income.

438. In truth and in fact, Defendants knowingly or recklessly failed to properly account for the Company's deferred tax assets as properly accounting for them would have revealed Freddie Mac's true capital inadequacy.

439. In addition to the violations of GAAP noted above, Defendants knowingly or recklessly presented Freddie Mac's financial results and statements in a manner that also violated at least the following provisions of GAAP:

(a) The principle that loan impairments be recognized when it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the agreement (SFAS No. 114);

(b) The principle that loan loss reserves recognize credit losses when it is probable that a loss has been incurred and the amount can be reasonably estimated (SFAS No. 5);

(c) The principle that decreases in future cash flows expected to be collected on certain loans or debt securities transfers be recognized as impairments (American Institute of Certified Public Accountant's Statement of Position 03-3);

(d) The principle that financial statement disclosure is to help investors and creditors understand what an entity is trying to accomplish with its derivative securities (SFAS No. 133);

(e) The principle that interim financial reporting should be based upon the same accounting principles and practices used to prepare annual financial statements was violated (APB No. 28, ¶10);

(f) The concept that financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions (Concepts Statement No. 1, ¶34);

(g) The concept that financial reporting should provide information about the economic resources of an enterprise, the claims to those resources, and the effects of transactions, events and circumstances that change resources and claims to those resources (Concepts Statement No. 1, ¶40);

(h) The concept that financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it. To the extent that management offers securities of the enterprise to the public, it voluntarily accepts wider responsibilities for accountability to prospective investors and to the public in general (Concepts Statement No. 1, ¶50);

(i) The concept that financial reporting should provide information about an enterprise's financial performance during a period. Investors and creditors often use information

about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance (Concepts Statement No. 1, ¶42);

(j) The concept that financial reporting should be reliable in that it represents what it purports to represent. That information should be reliable as well as relevant is a notion that is central to accounting (Concepts Statement No. 2, ¶¶58-59);

(k) The concept of completeness, which means that nothing is left out of the information that may be necessary to ensure that it validly represents underlying events and conditions (Concepts Statement No. 2, ¶79); and

440. The concept that conservatism be used as a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered. The best way to avoid injury to investors is to try to ensure that what is reported represents what it purports to represent (Concepts Statement No. 2, ¶¶95, 97).

VIII. DEFENDANTS' MATERIALLY FALSE AND MISLEADING STATEMENTS DURING THE CLASS PERIOD[42]

A. Defendants Weave a Web of Lies

441. The Class Period begins on November 20, 2007. On that date, Freddie Mac issued its Financial Report for the Three and Nine Months Ended September 30, 2007 (the "November 20, 2007 Financial Report") along with an accompanying press release. The press release noted, in pertinent part:

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[42] In order to not just plead Defendants' false and misleading statements without any context, Plaintiffs have attempted to provide the Court with context in this section by bolding and italicizing Defendants' statements Plaintiffs contend are false and misleading.

McLean, VA – Freddie Mac (NYSE:FRE) today reported a net loss of $2.0 billion, or $3.29 per diluted common share, in the third quarter of 2007, compared to a net loss of $715 million, or $1.17 per diluted common share, for the same period in 2006. The company also reported a decrease in the fair value of net assets attributable to common stockholders, before capital transactions, of approximately $8.1 billion for the third quarter of 2007, compared to an increase of approximately $300 million for the same period in 2006. Compared to the second quarter of 2007, the company reported declines in both net income and fair value primarily due to increased credit-related expenses and losses on mark-to-market items.

"Without doubt, 2007 has been an extremely difficult year for the country's housing and credit markets and, as our third quarter financial results reflect, we have been impacted by the deterioration in these markets," said Richard F. Syron, Freddie Mac chairman and chief executive officer. "We recognized the challenges facing the mortgage markets, however, and have taken further steps to address them. At the same time, as our charter mandates, we have continued to meet our mission by playing a stabilizing role in the markets and supporting our customers.

"Freddie Mac is a housing finance company operating in what today is a troubled housing and credit market. It will take time for this market to turn around. ***But as it improves, we are optimistic about Freddie Mac's longer-term prospects. The market shift towards fixed rate originations and improved pricing and credit standards should position us well as the weakness in credit markets begins to improve and we are able to leverage our traditional strengths."***

"Weakening house prices and deteriorating credit have hurt Freddie Mac's results, as well as those of other participants in the mortgage market," said Buddy Piszel, chief financial officer. "You can see the impact of these trends in our credit results and throughout our financial statements. Year-to-date, we have recognized $4.6 billion in net credit-related items on a pre-tax basis."

"During the past year we have taken important steps to address the impact of the declining housing and credit markets to our business," Piszel added***. "We have begun raising prices, tightened our credit standards and enhanced our risk management practices. We also continue to improve our internal controls as we move closer to completing our remediation efforts and returning to timely financial reporting. These actions position us well to take advantage of opportunities when the current market dislocation ends."***

Freddie Mac's regulatory core capital was estimated at $34.6 billion at September 30, 2007, which represented an estimated $8.5 billion in excess of the regulatory minimum capital requirement, and an estimated $0.6 billion in excess of the 30 percent mandatory target capital surplus directed by the Office of Federal Housing Enterprise Oversight (OFHEO).

*　　*　　*

Capital Management

Estimated regulatory core capital was $34.6 billion at September 30, 2007, which represented an estimated $8.5 billion in excess of the regulatory minimum capital requirement, and an estimated $0.6 billion in excess of the 30 percent mandatory target capital surplus directed by OFHEO. Retained portfolio sales in September and October largely reflected activities to manage to the 30 percent mandatory target capital surplus.

* * *

442. In the November 20, 2007 Financial Report, the Company stated ***"[w]e believe our provision for credit losses and REO operations expense together provide a reasonable measure of the increased exposure to mortgage credit losses for our guarantee activities during each period."***

443. The November 20, 2007 Financial Report contained a section titled, "Mortgage Credit Risk," wherein the Company discussed its underwriting requirements and quality control standards:

We seek to manage the underlying risk by adequately pricing for the risk we assume using our underwriting and quality control processes.

* * *

444. The November 20, 2007 Financial Report also contained a discussion of Freddie Mac's participation in subprime and "Alt-A" loans:

<u>*Subprime Loans*</u>

Participants in the mortgage market often characterize single-family loans based upon their overall credit quality at the time of origination, generally considering them to be prime or subprime. There is no universally accepted definition of subprime. The subprime segment of the mortgage market primarily serves borrowers with poorer credit payment histories and such loans typically have a mix of credit characteristics that indicate a higher likelihood of default and higher loss severities than prime loans. Such characteristics might include a combination of high loan-to-value ratios, low credit scores or originations using lower underwriting standards such as limited or no documentation of a borrower's income. The subprime market helps certain borrowers by broadening the availability of mortgage credit.

We estimate that approximately $5 billion and $3 billion of loans underlying our Structured Transactions at September 30, 2007 and December 31, 2006,

respectively, were classified as subprime mortgage loans. With respect to our retained portfolio, at September 30, 2007 and December 31, 2006, we held investments of approximately $105 billion and $124 billion, respectively, of non-agency mortgage-related securities backed by subprime loans. These securities include significant credit enhancement, particularly through subordination, and approximately 97.6% of these securities were rated AAA at November 15, 2007.

Between September 30 and November 15, 2007, credit ratings for several mortgage-related securities backed by subprime loans with an aggregate unpaid principal balance of $2.5 billion were downgraded from AAA to a lesser investment-grade rating by at least one nationally recognized statistical rating organization. To date, we have not recorded any impairment charges on these securities because we have the ability and intent to hold these securities for a period of time sufficient to recover all unrealized losses; however, since these are designated as available-for-sale securities, there are $55 million of unrealized losses, net as of September 30, 2007 that are reflected in AOCI. We expect that these and any further credit downgrades of our non-agency mortgage-related securities backed by subprime loans will result in declines in their fair value.

* * *

Alt-A Loans

Many mortgage market participants classify single-family loans with credit characteristics that range between their prime and subprime categories as Alt-A because these loans have a combination of characteristics of each category or may be underwritten with lower or alternative documentation than a full documentation mortgage loan. Although there is no universally accepted definition of Alt-A, industry participants have used this classification principally to describe loans for which the underwriting process has been streamlined in order to reduce the documentation requirements of the borrower or allow alternative documentation.

We principally acquire mortgage loans originated as Alt-A from our traditional lenders that largely specialize in originating prime mortgage loans. ***These lenders typically originate Alt-A loans as a complementary product offering and generally follow an origination path similar to that used for their prime origination process. In determining our Alt-A exposure in loans underlying our single-family mortgage portfolio, we have classified mortgage loans as Alt-A if the lender that delivers them to us has classified the loans as Alt-A, or if the loans had reduced documentation requirements which indicate that the loan should be classified as Alt-A. We estimate that approximately $131 billion, or 8%, of loans underlying our single-family mortgage portfolio at September 30, 2007 were classified as Alt-A mortgage loans***. For these loans, our average credit score was 715 and our estimated current average LTV ratio was 72%.

We also invest in non-agency mortgage-related securities backed by Alt-A loans in our retained portfolio. ***We have classified these securities as Alt-A if the securities***

> ***were labeled as Alt-A when sold to us or we believe the underlying collateral includes a significant amount of Alt-A loans. We believe that $53 billion and $54 billion of our single-family non-agency mortgage-related securities that are not backed by subprime loans are generally backed by Alt-A mortgage loans at September 30, 2007 and December 31, 2006, respectively***. We have focused our purchases on credit-enhanced, senior tranches of these securities, which provides additional protection due to subordination. Approximately 99.9% of these securities were rated AAA as of September 30, 2007 and none had been downgraded as of November 15, 2007.

* * *

445. Later that morning, Defendants held an earnings conference call to discuss the Company's third quarter 2007 financial results. The Individual Defendants participated in the call on behalf of the Company. On the call, Defendants insisted that Freddie Mac's financial condition had stabilized, the Company was well-capitalized, and that Defendants had the situation under control. For example, Syron touted the "strong steps" the Company was taking to ***"improve our business and our future financial results."*** Syron continued by stating that:

> ***We do not believe it would be wise to be sanguine about the intermediate term housing market. Thus, we are determined to take strong steps and be in front of whatever happens. We are all very strong believers in both the long-term opportunities for shareholders and in our obligations in times like this to meet our charter by stabilizing markets.***
>
> ***The actions that Buddy [Piszel] and Patti [Cook] will discuss are aggressive, forward-looking and financially prudent and they will ensure that we are able to fulfill our mission and to meet our responsibilities to our shareholders at the same time***. Notwithstanding the extremely tough market in the third quarter, Freddie Mac benefited from our traditional strengths as net interest income and guarantee fees continued to grow. Buddy [Piszel] will discuss these trends when he takes you through our financials. In particular, he will focus on how credit impacted the results. ***In addition, we have taken sound steps since early 2007 to advance our mission, improve our credit exposure and enhance our long-term profitability. As a result, through the third quarter, our credit position has remained among the strongest in an admittedly troubled industry and the conventional conforming market, where the vast majority of our exposure is, has held up well***. Patti [Cook] will review how we have managed our credit position and will discuss some of the current opportunities we are seeing in the business.

* * *

446. Syron continued by claiming that the Company was bolstering its capital position:

> ***Before I turn it over to Patti [Cook], I want to reiterate to everyone on the call that the GSEs were set up for times like these. Over time, Freddie has prospered by committing capital in these environments, managing credit and interest rate risk to acceptable levels and earning attractive long-term results. Given the current opportunity set in both of our businesses, we feel that we should remain focused on the fundamentals of our business. As a result, the right thing for us to do now is to take steps to bolster our capital position in order to strengthen our franchise and better position us for the future, and that's exactly what we're doing.*** With that, I'll turn it over to Patti [Cook].

* * *

447. Following Syron's comments, Cook made the following statements concerning Freddie Mac's financial condition:

> Thanks, Dick. These are certainly volatile and challenging times in the U.S. housing and financial markets. I will address how this environment is affecting our current business and the prospect for our future business. I will touch on the credit quality and expected profitability of our guarantee fee business, the credit quality of the asset-backed securities in the retained portfolio, and the outlook for profitability in both. ***In summary though, I would say that what is "bad" for current profitability is "good" for the longer term prospects of Freddie Mac. As you will hear, we are clearly more relevant and needed today than we were a year ago, which is creating opportunities for us to improve our longer-term profitability.***

* * *

> Let's turn to the current market environment and its impact on our G-fee business. On slides eight and nine, we have updated the information we provided on our second quarter call. ***As in June, our current credit position remains relatively strong across our total portfolio. In aggregate, Freddie Mac benefits from a very low current LTV ratio of 60%, high average FICO scores of 724, and a serious delinquency rate of just 51 basis points, a level that is roughly half of the market average.*** However, our 2006 and 2007 books are expected to realize higher expected default costs than prior books for two reasons. First, the recent weakening in the house price -- of house prices have increased expected default costs for the 2006 and 2007 books compared to prior years. Second, there was an increase with risk layering mortgages. ***For example, mortgages with FICO scores less than 620 and original LTVs greater than 90, are more concentrated in the 2007 book and represent about 1% of purchases.***

> On the guarantee fee business, we use market prices to mark all credit related exposures. In the third quarter, the market prices for credit deteriorated significantly and I believe that the market is putting a big risk premium into the price they quote,

especially on prime conventional mortgages. Let me put this in perspective. The guarantee obligation including related items was $16.8 billion at the end of September. For this value to represent the present value of future default costs on our guarantees, we would need to see default rates in the 4 to 5% range and severities around 30%.

A more reasonable assumption might be defaults of 3 to 3.5% and severities of 30%, resulting in total present value of default costs of $10 billion to $20 billion over the life of the portfolio. This is with some areas such as California experiencing declines in house prices of 25 to 30%. To put this in perspective, our worst performance was the portfolio we held as of 1991, which went on to experience a 2.6% default rate and a severity of about 30%. So we would need to experience a scenario approximately twice as severe as the 1990s to see the GO realized.

Also a note of caution, when comparing these lifetime numbers to charge-offs, this type of analysis includes not only charge-offs but also REO expense and lost interest. ***So to summarize, the difference between the $10 billion to $12 billion that I quoted and the $16.8 billion can be thought of as an expression of the market's uncertainty about the future, which manifests itself in wider spreads. So unless the conventional conforming default rate rises to a level of 4 to 5%, we would expect to earn some of the GO mark back over time.*** And remember, as of now, we are seeing single-family serious delinquencies as of September 30, 2007 of 51 basis points.

To address the declining profitability that results from the decline in the housing market, we have taken steps throughout 2007 to increase prices and limit our credit exposure…

* * *

In sum, while the housing market remains challenging, we are comfortable with our ability to adjust prices and terms of business, to enhance the profitability of our securitization business going forward.

Let's turn to a discussion of the risk profile and profit outlook for the retained portfolio. ***The credit profile of our retained portfolio remains of the highest credit quality with 57% in agency mortgages and 33% in non-agency securities, of which 97% is AAA rated and does not include any CDOs.*** These asset-backs are critical to our ability to meet our affordable lending objectives and allowed us to invest in non-prime markets with substantial credit enhancements. ***Despite the continued deterioration of the housing market and increases in non-prime delinquencies, we remain comfortable with our risk position on these assets. For the subprime securities, while we have experienced some downgrades, we have high levels of subordination that support these investments, as shown on slide ten. Even at a 50% cumulative default rate and 50% severity assumption, no losses are projected on these securities.*** There are also about $26 billion of Alt-A and $21 billion of

MTA asset-backed securities in the portfolio, which we have grouped together in this slide with an average suborder -- with average subordination levels of 16% and 22% respectively. ***While the overall book should have sufficient subordination to withstand continued deterioration in housing and performance, there are some chances of losses, although unlikely, on a few individual bonds, given the variation in subordination levels.***

* * *

So there you have it. From a business perspective, even in this difficult business environment, we continue to benefit from a relatively strong credit position. We will have higher core spread income in the retained portfolio. We have taken steps to continue our mission and improve our business and we are experiencing significant growth and pricing power in our G-fee business. ***All of these business drivers will contribute to improved returns over the long-term.***

* * *

448. Following Cook, Piszel then discussed the Company's projected losses and capital position:

Our guarantee fee business experienced a $7 billion pretax reduction in value, due to significant declines in the market value of the net guarantee asset and guarantee obligation and widening credit spreads and the lower market prices on our portfolio of delinquent loans. ***This resulted in a GO that Patti referred to of approximately $17 billion, which overstates what we expect to become realized credit losses. A more reasonable outcome is $10 billion to $12 billion. I think there was a glitch in Patti's script when she gave $10 to $20 billion. She meant $10 to $12 billion.***

* * *

Which brings me to capital. As of September 30th, we had $8.5 billion of capital over the statutory minimum capital, but only $600 million over the 30% mandatory capital surplus target.

Given the opportunities to deploy capital, and uncertainty of our GAAP results and credit conditions, as well as uncertainties on the relief of the 30%, we are planning on taking several actions to bolster our capital. First, we have engaged Lehman Brothers and Goldman Sachs to help us consider capital raising alternatives in the very near term. Second, we are seriously considering a 50% reduction in our common dividend. ***These actions, coupled with other management steps, should provide sufficient capital flexibility for us to manage the Company for our shareholders and meet our charter through the balance of this credit downturn. When things return to normal, we are committed to returning the excess capital to our shareholders.*** With that, let me turn things back to Dick.

* * *

449. Syron then made the following statements concerning the Company's capital position:

> Thanks, Buddy. We've given you a lot of information today in context. I just want to leave you with a couple of very short comments that are hopefully straightforward. ***Our situation is we have a 30% mandatory capital requirement and we are committed to meeting that.*** At the same time, our accounting is volatile, to say the least. And that drives much of what we have been talking about. Having said that, one, we're taking the challenges that Freddie places extremely seriously, as I know you believe we are, and we're focused on them intensely and, we believe, very realistically. ***Two, we're putting in place a very active capital management plan that will allow us to manage our business consistent with the needs of the market environment, benefit our shareholders and put this situation behind us. Three, we have identified a clear path to improve our financial results and we're moving down that path very aggressively...***

* * *

450. Although the Company reported negative news, with the common stock falling from a closing price of $37.50 on November 19, 2007 to a close of $26.74 on November 20, 2007, and with the preferred stock falling as much as 19%, Defendants continued to mislead the market. Indeed, had Defendants not made false and misleading statements and revealed the Company's true financial condition, market expectations would have been corrected even more and the common stock price would have fallen further.

451. So the Class Period begins with Defendants making false and misleading statements to distance Freddie Mac from its huge $2.0 billion loss and "spinning" this negative news to minimize the decline in the trading value of Freddie Mac common and preferred shares. These statements were intended to and did obfuscate the Company's true financial condition and mislead the market as to the Company's future business prospects. As a result, Freddie Mac's equity securities continued to trade at artificially inflated levels. As demonstrated below, Defendants continued to mislead the market throughout the Class Period.

452. The statements referenced in ¶¶441-49 were each materially false and misleading when made as they represented and/or omitted adverse facts which then existed and disclosure of which was necessary to make the statements not false and/or misleading. The true facts, which were known to or recklessly disregarded by each of the Defendants, were:

- Defendants knew Freddie Mac's capital was inadequate both for the risks Defendants knew the Company was facing and for meeting regulatory requirements. To this end, Defendants manipulated Freddie Mac's accounting methods so as to grossly overstate the Company's capital position. These overstatements were discovered by regulators immediately before Freddie Mac was placed into conservatorship on September 7, 2009, and were the proximate cause of the conservatorship decision.

- Defendants accomplished their capital deception by pushing losses into the future so as to avoid the recognition of a massive capital shortfall sufficient to wipe out the Company's entire capital base. These unrecognized impairments included: multi-billion dollar impairment losses on Freddie Mac's ABS investments; multi-billion dollar losses on tax-deferred assets and tax credits that were useless to the Company and could realistically never be utilized for the Company's benefit; multi-billion dollar losses on defaulted loans generally; and multi-billion dollar losses due to a change in the Company's policy regarding recognition of losses on defaulted loans in its guarantee portfolio.

- Defendants never disclosed during the entire Class Period the essential fact that if stated truthfully, Freddie Mac's capital was both inadequate for the risks Defendants knew the Company was facing and was below regulatory requirements.

- Defendants never disclosed during the entire Class Period the essential fact that Freddie Mac's systems and procedures relating to its financial condition, loan underwriting review and approval, loan acquisition and ongoing monitoring, quality control, fraud detection and fraud prevention were either inadequate or so compromised by overrides as to lead to material misstatements of its financial position and to cause it to take on massive levels of mortgage credit and interest rate risk. Moreover, these undisclosed problems rendered the Company incapable of pricing for the tremendous risks it was assuming through non-prime and non-traditional loan exposure.

- The Company was not positioned well and had not taken "important steps to address the impact" of the housing market crash. To the contrary, after conducting risk management meetings and creating a risk report in August 2007 to assess the severity and implications to Freddie Mac of the subprime crash, Freddie Mac did not put the necessary systems and measures in place to address the identified risks, even as the key risk indicators manifested themselves. As a result, Piszel's and the other Defendants' statements regarding, among other things, the Company's capital adequacy, were false and misleading when made. By not disclosing the Company's

ongoing failure to implement mitigation plans in spite of experiencing identified key risk indicators, Defendants misled the market.

- Defendants failed to disclose that Freddie Mac was one of the fundamental, primary causes of the explosion in the growth of non-prime and non-traditional mortgages through the Company's gorging on risky, default prone loans. Indeed, the Company could not "remain focused on the fundamentals of [its] business" because, unbeknownst to the market, Defendants had deliberately forsaken those fundamentals (*i.e.*, traditional, prime loans) and indulged Freddie Mac on a feast of subprime and Alt-A mortgages. Therefore, the Company could not be "in front" of the collapsing housing market. Indeed, the Company was neck deep in non-prime and non-traditional mortgage loan exposure, and its 2005, 2006, and 2007 single family purchases were known by Defendants to be virtual ticking time bombs capable of decimating the Company's financial condition.

- Defendants never disclosed to the market that they ignored repeated internal warnings from several high-ranking Company officials to stay away from acquiring or exposing the Company to non-prime and non-traditional mortgage loans, and that buying such loans would pose an enormous financial and reputational risk to the Company. In fact, as was reported near the close of the Class Period, rather than heed these warnings, Defendants fired the Company's Chief Risk Officer, Andrukonis. The impact of this firing, together with other statements, actions, and inactions during the Class Period, created and perpetuated a culture that stifled any dissent to Defendants' relentless pursuit of market share, regardless of the cost to the Company's financial condition.

- Defendants knew, notwithstanding their Class Period statements, that they were taking strong steps to improve the Company's risk position in present and future books of business, the underlying credit quality of Freddie Mac's guarantee and retained portfolios was so feeble as to materially threaten the Company's ability to continue as a going concern. This was due to the following facts, which Defendants hid from the market during the Class Period:

    - In each of 2005, 2006, and 2007, 50% or more of the Company's single family purchases consisted of subprime, Alt-A, or other non-prime loans or securities, with the result being that 35% of its entire single-family credit exposure consisted of such high risk loans or securities;

    - The massive amount of high risk purchases made in 2006 and 2007 occurred as the real estate bubble was bursting and as others were withdrawing from the market;

    - The Company's 2007 single-family credit exposure book had the highest risk characteristics of the 2005-2007 period;

- Operating with an extremely high leverage ratio, Freddie Mac's capital base was woefully inadequate given its level of credit risk, except under unsustainable and extremely favorable home price appreciation circumstances;

- The risks posed by Freddie Mac's high leverage ratio were compounded by the fact that its stated capital level was consistently misstated and essentially illusory, a fact discovered by federal regulators only in the weeks leading up to its being forced into conservatorship;

- Defendants created the fiction that Freddie Mac did not guarantee or buy subprime loans because it only purchased prime loans. This was so Defendants could disguise the true high risk nature of Freddie Mac's single-family credit exposure. It also allowed Defendants to continue the fiction created specifically for its shareholders that Freddie Mac's strength was the strong underlying credit quality of its guarantee and retained portfolio and that Freddie Mac's highly leveraged condition did not pose a threat. At the same time, Defendants pursued the Company's high-risk business in massive quantities so as to meet the Company's increasing affordable housing goals;

- By blending Freddie Mac's ever increasing percentage of subprime and non-prime loans in with its still sizable low-risk book of traditional prime loans, Defendants were able to disguise and hide the materially negative impact of the Company's substantial and materially increasing levels of non-prime credit risks; and

- The unseasoned nature and massive size of the 2005-2007 book, artificially tempered and minimized by the low delinquency rates on its older, low risk traditional book, allowed Defendants to continue to misleadingly tout Freddie Mac's seemingly low delinquency rate.

453. On November 27, 2007, Freddie Mac issued a press release announcing the terms of a $6 billion equity offering. The press release stated, in pertinent part:

> **Equity Offerings**
>
> On November 27, 2007, Freddie Mac announced that it will issue $6 billion of non-cumulative perpetual preferred stock. The issuance will involve a larger offering of non-convertible noncumulative perpetual preferred stock, and a substantially smaller offering of convertible noncumulative perpetual preferred stock. Both offerings are expected to price in the near term.
>
> ***Last week, Freddie Mac announced that, in order to meet the 30 percent mandatory target capital surplus directed by the company's safety and soundness regulator, the Office of Federal Housing Enterprise Oversight (OFHEO), as well as to have the flexibility to further its franchise value, it planned to take near-term***

capital raising actions. As also announced, the company has decided to reduce its fourth quarter common stock dividend to $0.25 per share.

> Freddie Mac's estimated regulatory core capital was approximately $34.6 billion at September 30, 2007. Freddie Mac's minimum capital requirement at that date was $26.2 billion and the 30% mandatory target capital surplus was an additional $7.9 billion. Accordingly Freddie Mac's estimated regulatory core capital at September 30, 2007 represented an estimated cushion of $8.5 billion in excess of the company's regulatory minimum capital requirement and an estimated surplus of $0.6 billion in excess of the 30 percent mandatory target capital surplus imposed on the company by OFHEO. The capital raised through this offering will be used to bolster the company's capital base in light of actual and anticipated losses necessitated by GAAP accounting requirements and help Freddie Mac meet the 30 percent surplus going forward.
>
> ***"Freddie Mac is announcing today a proactive capital management plan that will help us meet the 30 percent surplus and address regulatory concerns and GAAP accounting requirements, provide sufficient capital to continue fulfilling our important housing mission through the current market environment, and better position us to effectively manage the company going forward,"*** said Freddie Mac Chairman and Chief Executive Officer Richard F. Syron.

* * *

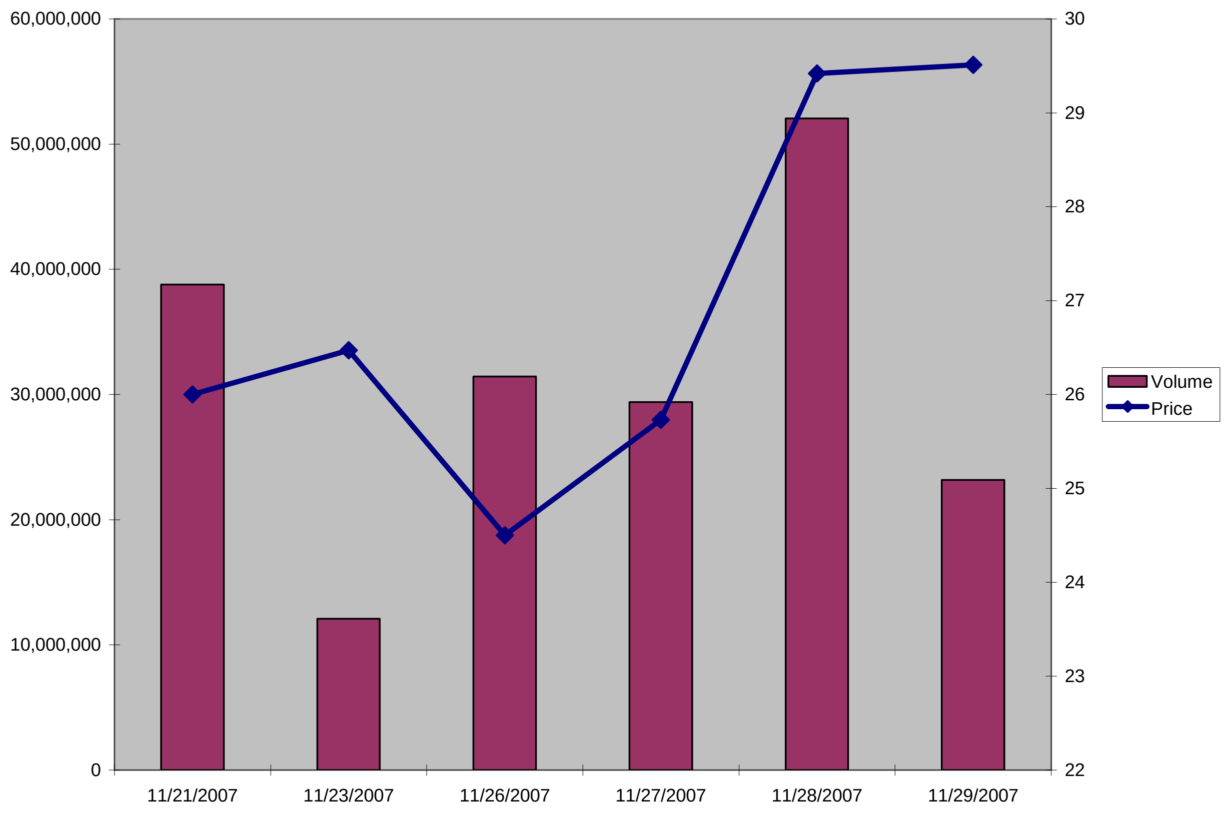
454. On November 29, 2007, Freddie Mac launched its $6 billion initial public offering of 240 million shares of the Series Z preferred stock, with an annual dividend of 8.375%, at an offering price of $25 per share. The offering circular for the Series Z preferred stock offering (the "Offering Circular") was drafted and reviewed by the Individual Defendants, and summarized, and incorporated by reference, the Company's most recent annual report and quarterly financial reporting, including their statements concerning the Company's capitalization and exposure to risk. According to the Offering Circular:

> The capital raised from the sale of the Preferred Stock will be used to bolster our capital base in light of actual and anticipated losses necessitated by GAAP accounting requirements and help us meet the 30% surplus going forward. We expect to deploy such proceeds for the purchase of residential mortgages or mortgage-related securities (subject to regulatory constraints), for the financing of growth in our mortgage guarantee business and for other corporate purposes consistent with evolving business and market conditions.

* * *

OFHEO has never classified us as other than "adequately capitalized," the highest possible classification reflecting our consistent compliance with the minimum, critical and risk-based capital requirements.

455. In response to false and misleading statements contained in the November 23, 2007 *New York Times* article and the November 27, 2007 press release, the price of Freddie Mac common stock dropped slightly from November 23, 2007 to November 26, 2007 (the next trading day) before rising sharply on news of the Company's capital plan from a closing price of $25.73 on November 27, 2007, to a peak of $30.50 and a close of $29.42 on November 28, 2007 – an increase of 14.3% on volume of more than 52 million shares, as demonstrated in the chart below:



456. Freddie Mac preferred shares also increased as much as 10.8%.

457. The statements referenced in ¶¶453-54 were each materially false and misleading when made for the reasons set forth in ¶452 and the factual detail contained throughout this Complaint. In addition, the statements referenced in ¶¶453-54 were materially false and misleading

when made because they represented and/or omitted adverse facts which then existed and disclosure of which was necessary to make the statements not false and/or misleading. The true facts, which were known to or recklessly disregarded by each of the Defendants, were:

- The data in the Offering Circular reflected a patently inadequate write-down of the Company's investments in subprime and so-called Alt-A mortgages. The Company was deficient in failing to establish a sufficient reserve for its guarantees of ABS based on non-prime and non-traditional loans. As a result, the asset values reported in the Offering Circular, and documents incorporated by reference into the Offering Circular, drastically overvalued Freddie Mac's portfolio of Alt-A mortgages and related non-prime securities and had the concomitant effect of misrepresenting its capital sufficiency.

- Defendants knew the sale of the Series Z preferred stock would not provide the Company with "sufficient capital" to manage the Company going forward. In reality, Defendants were forestalling the inevitable erasure of the Company's capital base, and knew any capital raised in the Offering would soon be wiped out by, among other things, the key risk indicators manifesting themselves that the Company was not prepared to address, as well as the impending recognition of substantial losses Defendants pushed into the future through accounting sleights of hand.

458. On December 10, 2007, Freddie Mac issued a press release announcing changes for the purchasing of delinquent loans from pools underlying Mortgage Participation Certificates. The press release announced, in pertinent part:

> On December 10, 2007, Freddie Mac announced that the company will generally purchase mortgages that are 120 days or more delinquent from pools underlying Mortgage Participation Certificates ("PCs") when:
>
> - the mortgages have been modified;
> - a foreclosure sale occurs;
> - the mortgages are delinquent for 24 months; or
> - the cost of guarantee payments to security holders, including advances of interest at the security coupon rate, exceeds the cost of holding the nonperforming loans in its mortgage portfolio.
>
> Freddie Mac had generally purchased mortgages from PC pools shortly after they reach 120 days delinquency. From time to time, the company reevaluates its delinquent loan purchase practices and alters them if circumstances warrant.

> Freddie Mac believes that the historical practice of purchasing loans from PC pools at 120 days does not reflect the pattern of recovery for most delinquent loans, which more often cure or prepay rather than result in foreclosure. Allowing the loans to remain in PC pools will provide a presentation of its financial results that better reflects Freddie Mac's expectations for future credit losses. Taking this action will also have the effect of reducing the company's capital costs. The expected reduction in capital costs will be partially offset by, but is expected to outweigh, greater expenses associated with delinquent loans.

* * *

459. On December 11, 2007, Defendants Syron and Piszel participated in a conference call at the Goldman Sachs Financial Services Summit. Syron and Piszel continued to trumpet the company line that the worst was behind Freddie Mac and that the Company was well-positioned and poised to rebound:

> **<u>Dick Syron – Freddie Mac Chairman and CEO</u>**
>
> * * *
>
> Now, while our credit expenses have remained -- have increased significantly in the past six months, ***our portfolio, and we have some data to show you this, remains one of the strongest in the mortgage/finance industry***...
>
> * * *
>
> ***Our management team has taken significant steps through 2007 to enhance our ability to weather this downturn, which is really very, very significant***. And I agree with people that say this is the most important correction we've had in housing since World War II. ***As our successful preferred offering last week shows, our senior management is committed to take the changes that serve our charter mission and doing so, though, in a way that fulfills our fiduciary responsibility to our shareholders***. And let me come back to how we constructed that offering and how that reflects this.
>
> Now, it may seem obvious that we're a rather unique financial institution. You're going to hear from the one other institution that makes us not unique a little later today. ***Unlike banks and brokerages, Freddie is chartered to focus solely on the $9.4 trillion conventional/conforming residential mortgage market***. And our mission, as stated in our charter, which is our core asset, is to provide liquidity, stability, and affordability across the cycles, good times and bad, to our customers.
>
> * * *

Now, an important factor is that, over time-- our regional diversification, and we can talk to you about that, and our focus on conventional/conforming, prime loans has helped Freddie to promote affordable home ownership but has also helped us to record credit losses that are far lower than the industry as a whole. So you could look at the business, I guess, on your left as kind of a credit risk management business. If you look on the right, we have a portfolio of our own. It's got a balance of around $700 billion. And we invest it in securities, where we manage interest rate risk. So the left side is kind of credit risk; the right side is interest rate risk.

The case historically has been that (inaudible) very, very low levels of interest rate and credit risk in our retained portfolio. Specifically, 99% of the securities in the portfolio business, the one on your right, have security ratings of AAA or better in a duration gap over time. We focus a lot on duration that's average zero months. We're a matchbook provider. We don't bet on the direction of interest rates. We make money over the long term, through the core spread (inaudible) the portfolio.

What's the takeaway? ***The takeaway from this slide is that, over time, Freddie has succeeded in generating good returns from both our guarantee and investment businesses while keeping our risk exposures very low. We're a high-leverage, low-risk operation. This strategy has enabled us to profit with others when times are good and to help keep serving our mission, strengthen consumer ties, and build market share when times are tough, like they are now.***

* * *

In our guarantee business, the $1.7 trillion business, there's been a shift in originations back towards kind of our sweet spot, or our wheelhouse - back towards long-term, fixed-rate products. That has helped us to increase our total market share penetration of the total U.S. mortgage market to about 28% through the end of September. This is a dramatic change from relatively recent periods, when there were very, very high ARM productions, and a lot of the high ARM productions went to the Street to be securitized.

* * *

The volumes that I talked about with our increase to 28% in the overall market are coming in a much improved pricing environment and tighter credit standards than a few years ago. ***As credit has tightened and private-label securitization has declined and almost dried up, we've experienced better pricing in our guarantee business while actually being able to tighten credit standards at the same time …***

* * *

This is the great irony of this. I'm going off script here for a second. ***Because of accounting and other issues, and Buddy will get into this, we've reported really ugly numbers. Let's face it; really ugly numbers. But we reported really ugly numbers at a time where the business that we're taking in, as you look at what's coming through the door, has got terrific returns on it. So it's a matter-- And we,***

to some extent, decided to take our pain up front, and we can get into that later on. But we took a very, very, very aggressive approach towards looking at potential future credit losses, which makes the current situation look pretty lousy, if I can use that word, at the same time that our business going forward looks better and better. It's an odd situation.

* * *

I can't stress this too much. Whereas the returns available to us in the retained portfolio were relatively unattractive throughout the 2004 to 2006 time, and a lot of business returns were unattractive, the ROEs on new business we achieved in the last year have been much, much better. Now, while we're not aggressively growing the retained portfolio in the interest of being sure we keep our capital powder dry, we're not shrinking it either. And we've been able, as our assets roll over-- about $10 billion a month rolls over through the retained portfolio-- to replace that with more attractive business coming on.

460. Syron concluded by discussing the Company's exposure to non-prime loans:

Finally, we feel that our credit position in the current guarantee book, actually, is very near the best of the entire industry. A very major reason for this is that we have very low exposures to Alt-A in risk-layered mortgage products in the guarantee business. ***<u>We didn't do any subprime business</u>***. And, if you look at layered products and Alt-A, they together amount to about 9% of our total guarantee portfolio. As a result, thus far, we have a delinquency rate-- a serious delinquency rate of about 51 basis points. The rate for the industry as a whole is about 100 basis points, or about 1%. ***So, if you look at that, and I think it is a valuable lead indicator, it shows the relative - relative - security of our portfolio. Now, this combination of improved pricing and margins on new business with continued low risk in our existing portfolio is what we think bodes well for our future***.

* * *

As I said, and I think the chart reflects this, our current expectation is for housing prices in the United States to fall about 10% peak to trough. ***Now, don't forget; what's important for us is the decline that occurs in the prime conventional space - not in the jumbo space and not in the subprime space and not largely in the investor space - but in the prime conventional space***. And we think this is a relatively – It's worse than anything we've seen. We think it's a relatively conservative and pessimistic strategy. ***And we think that, as we look at our portfolio, given areas that we can't invest in, like California, we'll get a better draw, if you will, on credit risk than the market as a whole***.

In this forecast, the important numbers are really that we expect a default rate of about 3% to 3.5% and a severity rate of 30%. The product of those two numbers is what you lose. To put it in context of the worst that any of us have seen has been a decline-- it's about 2.4% in defaults and a 30% severity. ***So we think we've taken***

prudent steps to provide for what's going to come. Now, there are other things we could do, and we're prepared to deal with them, short of the world totally melting.

If our expectations are realized, we would expect that our total future credit losses from our current book of business will total approximately $10 to $12 billion. The reason I wanted to raise that number is, a lot of you, I think, realize that, in the interest of credibility, we decided some time ago that we were not going to mark to market expected credit losses in our portfolio – that, rather, we would go out to the Street, to you all collectively, in a sense, and we'd ask you – How would you price our book? Now, we're asking you from an obligation perspective. We're asking you to price something that you don't deal in. We're asking the Street to do that. So, particularly during this period of time, you're naturally going to do that fairly cautiously. The number they came up with for the obligation in our book is about $16 to $17 billion. That's the number we used, even though we think, based on the numbers that we gave you about the 10% decline in the severity and default ratios, that what we'll really realize is close to $10 billion. So we built in kind of a cushion here. ***And it would take a credit environment-- To realize the $17 billion that we built in, it would take a credit environment that was more than twice as bad as the worst experience we've seen since World War II. So we think that we've been quite cautious in this, but we've done it in the interest of trying to assure people where we are and where we're going***.

* * *

461. Following Syron's comments, Piszel made the following statements concerning the Company's ABS portfolio:

The first point is - We still have a lot of confidence in our subprime and alt A-backed ABS. . .

* * *

This next slide makes the point about the high credit quality of the overall retained portfolio. . .

* * *

So, despite all the noise, we feel really good about the ABS and the alt A-backed portfolios. . .

* * *

462. During the question and answer session, Piszel continued to mislead investors as to the Company's expected credit losses:

<u>Unidentified Audience Member</u>

(Inaudible question - microphone inaccessible)-- that the results had covered, basically, half of that credit loss. So, if those expectations play out, wouldn't you essentially erode the new capital that you just raised?

Buddy Piszel - Freddie Mac - EVP and CFO

Well, you think about the timing in which this is going to emerge. And I said that we're trying to take some actions, because the big way that the credit emerged in the third quarter was on these marks. ***And some of the marks and some of the accounting we're trying to get out of because we don't think it's representative of where, ultimately, the credit will come from and the way it should be emerging in the numbers. So, you're right. We said that we're expecting defaults in the $10 to $12 billion range overall. We've taken $4.5 billion through the first three quarters. So we're basically halfway there. We're assuming we're going to take the rest over the next couple years. But, remember, we're getting earnings. So there's retained portfolio earnings, there's the fees that we're earning on top of that. We've announced the fee increases. There's going to be reduction in the G&A. So there's a lot of other sources of profits that contribute to what the overall P&L outcome is going to be.***

*   *   *

463. Later on the call, Syron downplayed the Company's exposure to the subprime market:

Unidentified Audience Member

I just wanted you to comment on some of the home price appreciation expectations. You mentioned that maybe a year ago you were predicting a flat HPA, and some others might have been maybe more aggressive - the National Association of Realtors, for example. Now you're looking at a 10% decrease, yet you also mentioned that there was-- maybe one-third of the subprime owners should never have owned homes. I would imagine anyone who's an insider understood about the mortgage brokers and the conflicts there and the lending practices and the [wire] loans and the phony appraisals and all those things that are now fairly well known. But the insiders knew about them. So how can you be so confident that there isn't a permanent change or a semi-permanent change in demand for these types of products, the option ARMs, etcetera. You're raising fees, maybe justifiably. But it's going to be much harder to get a loan. So 10%, and, obviously, [I] think a higher number for Florida and California, actually, again, seems to be a little bit too optimistic in my view. So can you comment on that? And, given the track record of people in terms of that--?

Dick Syron – Freddie Mac Chairman and CEO

Sure. If you go back to a year ago, I think we were expecting-- We've been expecting some negative. I wasn't expecting as much negative as we're seeing. But let's put this in context. This is a very different decline in housing prices than we've

seen before. This is going to be about a two-and-a-half-minute answer. I'll try to keep it to one and a half. All the previous declines that we've seen, including during the '20s, were driven by economics. This is the first one I can find, and there's a lot of international factors -- I won't go into that-- that's been driven, in material, by a bubble. Having said that, a 10% decline in housing prices, and I'm talking in the prime conforming space -- I'm not talking of translating that into taking into consideration what happens when the above $417,000 -- what happens in the subprime stuff. ***In terms of our insight into the subprime stuff, we didn't buy any subprime loans. I mean, we bought some securities, which we can go through, and we think we're fine in. We bought them for goal purposes. But we didn't buy in guarantee, essentially, any subprime loans. So we weren't in that business***. So we think, given the business that we're in, a 10% price decline is pretty good. It's a pretty good number.

* * *

464. In response to false and misleading statements contained in the December 10, 2007 press release and the December 11, 2007 conference call, the price of Freddie Mac common stock fell from a closing price of $35.04 on December 10, 2007 to a closing price of $31.31 and $30.42 on December 11 and 12, 2007, respectively, while Freddie Mac's preferred shares fell as much as $3.10 per share. If not for Defendants' false and misleading statements and Defendants' systematic assurances that the Company was not facing material exposure to the withering of the subprime mortgage market, effectively distancing Freddie Mac from the negative financial consequences caused by the decline in the subprime market, the trading prices of the Company's securities would have declined even further during this time period.

465. The statements referenced in ¶¶458-63 were each materially false and misleading when made for the reasons set forth in ¶452 and the factual detail contained throughout this Complaint. In addition, the statements referenced in ¶¶458-63 were materially false and misleading when made because they represented and/or omitted adverse facts which then existed and disclosure of which was necessary to make the statements not false and/or misleading. The true facts, which were known to or recklessly disregarded by each of the Defendants, were:

- The Company's announcement of its decision to forestall purchases of loans that were 120 days or more delinquent from pools underlying PCs in its Guarantee Fee portfolio ***by 2 years*** did not represent a *bona fide* "reevaluation" of the Company's delinquent loan purchase practices. Rather, it represented a consequence of Defendants' fraud. If they did not delay purchases of the subprime and non-prime defaulting loans underlying the Company's PCs, the Company would be forced to recognize massive financial losses that would have eliminated the Company's capital base in an instant. In addition, without such delay, Defendants would have had no choice but to have revealed the full extent of the Company's financial exposure to non-prime and non-traditional mortgages.

- The Company's portfolio was anything but strong. To the contrary, virtually all of the single family private MBS the Company purchased were not backed by investment grade loans – they were backed by Alt-A, subprime, and other default prone, non-prime and non-traditional loans. Indeed, during 2006 and 2007, ***100%*** of such purchases consisted of these non-prime and non-traditional loans. Also, during 2006 through 2007, Freddie Mac accounted for ***70%*** – or $120 billion – of the GSEs' subprime MBS purchases.

- Defendants knew, based on information identified in, among other things, the August 2007 risk report, that Freddie Mac's loans from 2005 through 2007 had significantly worse default rates than prior years, and that these defaults rates threatened the viability of the Company.

- Defendants had disguised Freddie Mac's exposure to high-risk loans by creating the fiction that the Company only purchased prime loans. Defendants were able to accomplish this deception by mislabeling non-prime loans as prime, and by blending Freddie Mac's ever increasing percentage of subprime and non-prime loans in with its still sizable low-risk book of traditional prime loans, hiding the from the market the fact that in each of 2005, 2006, and 2007, 50% or more of the Company's single family purchases consisted of subprime, Alt-A, or other non-prime loans or securities, with the result being that 35% of the Company's entire single-family credit exposure consisted of such high risk loans or securities.

466. On December 13, 2007, Bear Stearns Equity Research Analysts David Hochstim, CFA and Michael Nannizzi published an update from a meeting with Defendant Piszel which indicated that "[l]ow FICO, high LTV loans are accounting for a disproportionate portion of Freddie Mac's delinquencies and losses, ***but they are still a tiny portion of the total portfolio.***" With regards to Freddie Mac's capital adequacy, the same update noted that:

> ***[b]ased on changes the company is making to some of its business practices (repurchasing fewer delinquent loans) and changes it intends to make to some of its accounting policies, the current capital surplus should enable the company to***

> ***remain significantly over-capitalized through 2008 even if market conditions (and credit spreads) continue to deteriorate***.

467. Also on December 13, 2007, *Reuters* published an article entitled "GSEs may be allowed to grow if market dives – regulator," revealing Freddie Mac could be permitted to expand its business and cut its capital reserves. The article stated, in part, "[a]llies of Fannie Mae and Freddie Mac have called for OFHEO to let the companies' combined mortgage portfolios, valued at around $1.4 trillion, grow so they can absorb more home loans."

468. By misrepresenting the true risk facing the Company, Defendants' false and misleading statements convinced the market its capital adequacy was more than sufficient and that it could actually be lowered at the same time the Company expanded its mortgage portfolio. In response to the Bear Stearns report and the *Reuters* article (which evidence that Defendants' campaign to conceal the truth and downplay the Company's precarious financial circumstances worked), the common stock price posted a healthy gain of 7.3% on December 13, 2007, climbing from $30.42 on December 12, 2007 to $32.46 and outpacing the market in general, while the preferred shares gained as much as 2.7%. Thus, despite Defendants' knowledge of Freddie Mac's massive non-prime exposure and capital deterioration, Defendants were able to maintain and even expand the amount of artificial inflation in the Company's equity securities.

469. On December 27, 2007, *Reuters* published an article entitled "Fannie, Freddie had enough capital in Q3, says OFHEO," which further represented the manifestation of Defendants' false and misleading statements that the Company was adequately capitalized and not exposed to tremendous risk from the non-traditional and non-prime mortgage market. The article stated, in part:

> Fannie Mae and Freddie Mac were "adequately capitalized" through the third quarter when the U.S. home funding companies reported huge losses, the companies' regulator said on Thursday.

> The Office of Federal Housing Enterprise Oversight said both companies achieved the designation, the highest they can receive concerning reserves against possible losses, as of Sept. 30.
>
> OFHEO, the safety and soundness regulator for the nation's two largest sources of mortgage finance, said Fannie Mae had a 5.9 percent surplus above the OFHEO-directed requirement, while Freddie Mac's surplus was 1.7 percent above the requirement. The two companies are under an OFHEO mandate to hold 30 percent more capital than levels required before they were embroiled in accounting standards in recent years.
>
> The levels are down from the prior quarter at both government-sponsored enterprises, "primarily due to the credit and market-related stresses on income," OFHEO said in a statement.
>
> "The OFHEO announcement should be taken at face value and the implication is at least through the third quarter the losses on their portfolios did not push them beneath the capital requirement," said Charles Lieberman, chief investment officer of Advisors Capital Management LLC in Paramus, New Jersey.
>
> "The interesting question is: Will OFHEO do anything about the incremental 30 percent capital requirement above and beyond the normal capital requirement that was installed as punishment for their problems in accounting several years ago?"
>
> Fannie Mae reported a $1.52 billion loss in the third quarter, while Freddie Mac posted a $2 billion loss.
>
> The preferred stock offerings of $7 billion for Fannie Mae and $6 billion for Freddie Mac in the fourth quarter will help cushion the firms from falling below the required capital, OFHEO said.

* * *

470. The positive news had a positive impact on the price of Freddie Mac common stock, which rose nearly 4% from a close of $32.42 on December 26, 2007 to a high of $34.69 and a close of $33.70 on December 27, 2007. Likewise, the preferred shares rose by as much as $2.00 per share on that day. Clearly Defendants' strategy of insulating Freddie Mac by continuously downplaying and negative news continued to mislead the market and actually increase the artificial inflation in Freddie Mac common and preferred stock.

471. On January 25, 2008, Foxx-Pitt issued an analyst report indicating that ***"[w]e do not expect FRE to report a charge to earnings and therefore regulatory capital due to other-than-temporary impairment (OTTI) charges on its subprime exposure. . . "***

472. On the morning of February 28, 2008, Freddie Mac issued its Annual Report to Stockholders for the fiscal year ended December 31, 2007 along with an accompanying press release. The press release noted, in pertinent part:

> McLean, VA – Freddie Mac (NYSE:FRE) today reported a net loss of $3.1 billion, or $5.37 per diluted common share, for the year ended December 31, 2007, compared to net income of $2.3 billion, or $3.00 per diluted common share, for 2006. For the fourth quarter of 2007, the net loss was $2.5 billion, or $3.97 per diluted common share, compared to a net loss of $401 million in the fourth quarter of 2006, or $0.73 per diluted common share.
>
> "Today's economy represents one of the most severe housing downturns in American history, and our results reflect that difficult environment as well as Freddie Mac's steadfast commitment to its important mission of providing liquidity, stability and affordability to the U.S. housing finance system," said Richard F. Syron, Freddie Mac chairman and chief executive officer. "Throughout 2007, Freddie Mac worked tirelessly to protect distressed homeowners by stabilizing the conforming mortgage market and reducing mortgage foreclosures. In addition to leadership on behalf of homeowners, we are keenly focused on managing our business through this difficult cycle towards a stronger future. ***As a clear sign of our progress, we are gratified that today's release marks Freddie Mac's return to timely financial reporting, an accomplishment that would not have been possible without the terrific efforts of everyone on the Freddie Mac team."***
>
> Looking ahead to 2008, Syron commented, "We remain extremely cautious as we enter 2008. If the economy weakens substantially from here – a possibility for which we need to be prepared as a company – it will have a further negative effect on homeowners across the country and drive credit costs higher. ***However, we have taken the steps to add capital, tighten our management of credit risk and institute pricing policies that are more consistent with the risk we bear. These actions should help us build the business for the future."***
>
> "With our large capital raise in the fourth quarter, we boosted our surplus relative to OFHEO's 30 percent mandatory target capital surplus," said Buddy Piszel, chief financial officer. ***"In 2008, we will continue to prudently manage our capital, particularly given the outlook for continued weakening in the housing market."***

* * *

Estimated regulatory core capital was $37.9 billion at December 31, 2007, which represented an estimated $11.4 billion in excess of the company's regulatory minimum capital requirement, and an estimated $3.5 billion in excess of the 30 percent mandatory target capital surplus directed by the Office of Federal Housing Enterprise Oversight (OFHEO).

* * *

473. In the Annual Report for the fiscal year ended December 31, 2007 (the February 28, 2008 Financial Report"), Defendants' represented that ***"[t]he turmoil in the credit and mortgage markets is also presenting opportunities to profitably grow our single-family and multifamily portfolios."***

474. In a section titled, "A Message from the Chairman," Defendant Syron advised shareholders of the 2007 financial results and the key trends for the Company moving forward, stating in part:

> ***It is essential to note that a significant portion of our losses were not economic, but the result of accounting conventions.*** Freddie Mac is committed to serving our mission for the long term and building enduring shareholder value. Yet in our business, mark-to-market accounting has the effect of increasing volatility and often requires us to book losses in excess of those that we ultimately expect to incur. ***Thus, a significant fraction of the credit impact from our current guarantee portfolio has already been reflected in our results. We expect a good portion of the "front-loaded" mark-to-market losses in our GAAP results will ultimately reverse over time.***
>
> There is a related dynamic at work here. Much of what Freddie Mac did in 2007 served our mission in ways that hurt our GAAP results in the short term. For example, the day we buy a loan and issue a credit guarantee, we have to mark the credit to market — and in this environment, that's generating large current-period losses (commonly called day one losses). ***Yet over the long run, with robust growth in our guarantee-fee business and wider spreads resulting from enhanced underwriting standards and increased guarantee fees, we expect the 2008 business we're putting on today to generate attractive returns tomorrow.***
>
> * * *
>
> Overall, I believe the market shift we saw in 2007 toward fixed-rate originations and improved pricing and credit standards positions Freddie Mac well, enabling us to build on our traditional strengths. Let me explain why.

> ***One key reason management believes strongly in Freddie Mac's future is the quality of our book of business, which we view as among the very best in the industry. Compared to our competitors, our mortgage portfolio is low in loan-to-value, low in holdings of exotic loans, high in regional diversification and high in credit quality.*** For example, following a year of marked deterioration in credit, our total single-family delinquency rate on December 31, 2007 was 65 basis points, still less than half the industry average — and well below that of our principal competitor. While we expect this to rise, it should remain substantially lower than others. ***As evident in our disclosures, even in a deteriorating credit environment, we believe our sound credit standards and policies will stand us in good stead.***
>
> A second positive factor involves how the markets have come back in our direction, in terms of quality as well as volume. Growth in total U.S. residential mortgage debt outstanding slowed to roughly 7 percent in 2007. By contrast, our total portfolio grew by 15 percent last year as Americans remembered the virtues of the American Mortgage — the long-term, fixed-rate, prepayable mortgage that remains a sweet spot for Freddie Mac. Moreover, across a range of products, much of the irresponsibility in pricing and credit began to be wrung out of the system.
>
> ***The shift away from exotic mortgages and back toward long-term, fixed-rate lending and more rational underwriting standards puts your company in a solid position going forward…***
>
> * * *
>
> ***The company remains safe and sound, and we continue to enhance our capital management and financial controls.*** We began the year with an estimated $2.1 billion capital cushion above the 30 percent surplus directed by our regulator; at year-end, this cushion stood at an estimated $3.5 billion. ***Credit quality is high, as discussed, and interest rate risk management remains strong…***
>
> * * *

475. The February 28, 2008 Financial Report contained a section titled "Capital Adequacy," which stated, in pertinent part:

> *Capital Adequacy*
>
> ***We estimate at December 31, 2007 that we exceeded each of our regulatory capital requirements, in addition to the 30% mandatory target capital surplus***. However, weakness in the housing market and volatility in the financial markets continue to adversely affect our capital, including our ability to manage to the 30% mandatory target capital surplus. Factors that could adversely affect the adequacy of our capital in future periods include GAAP net losses; continued declines in home prices; changes in our credit and interest-rate risk profiles; adverse changes in interest-rate

or implied volatility; adverse OAS changes; legislative or regulatory actions that increase capital requirements; or changes in accounting practices or standards.

* * *

476. The February 28, 2008 Financial Report also contained numerous additional false and misleading statements:

Underwriting Requirements and Quality Control Standards

All mortgages that we purchase for our retained portfolio or our credit guarantee portfolio have an inherent risk of default. ***We seek to manage the underlying risk by using our underwriting and quality control processes and adequately pricing for the risk.***

We use a process of delegated underwriting for the single-family mortgages we purchase or securitize. In this process, we provide originators with a series of mortgage underwriting standards and the originators represent and warrant to us that the mortgages sold to us meet these requirements. We subsequently review a sample of these loans and, if we determine that any loan is not in compliance with our contractual standards, we may require the seller/servicer to repurchase that mortgage or make us whole in the event of a default. We provide originators with written standards and/or automated underwriting software tools, such as Loan Prospector. We use other quantitative credit risk management tools that are designed to evaluate single-family mortgages and monitor the related mortgage credit risk for loans we may purchase. Loan Prospector generates a credit risk classification by evaluating information on significant indicators of mortgage default risk, such as LTV ratios, credit scores and other mortgage and borrower characteristics. ***These statistically-based risk assessment tools increase our ability to distinguish among single-family loans based on their expected risk, return and importance to our mission. In many cases, underwriting standards are tailored under contracts with individual customers***. We have been expanding the share of mortgages we purchase that were underwritten by our seller/servicers using alternative automated underwriting systems or agreed-upon underwriting standards that differ from our system or guidelines, which may increase our credit risk and may result in increased losses. ***We regularly monitor the performance of mortgages purchased using these systems and standards, and if they underperform mortgages originated using Loan Prospector, we may seek additional guarantee fee compensation for future purchases of similar mortgages***.

The percentage of our single-family mortgage purchase volume evaluated using Loan Prospector prior to purchase has declined over the last three years. ***As part of our post-purchase quality control review process, we use Loan Prospector to evaluate the credit quality of virtually all single-family mortgages that were not evaluated by Loan Prospector prior to purchase***. Loan Prospector risk classifications influence

both the price we charge to guarantee loans and the loans we review in quality control.

* * *

Portfolio Diversification

A key characteristic of our credit risk portfolio is diversification along a number of critical risk dimensions. We continually monitor a variety of mortgage loan characteristics such as product mix, LTV ratios and geographic concentrations, which may affect the default experience on our overall mortgage portfolio. ***As part of our risk management practices, we have adopted a set of limits on our purchases and holdings of certain types of non-traditional mortgage products that are deemed to have higher risks or lack sufficient historical experience to confidently forecast performance expectations over a full housing cycle. These loan products include option ARMs and loans with high LTV ratios, and mortgages originated with limited or no underwriting documentation.***

* * *

477. The "Credit Risks" section also contained a discussion on Freddie Mac's participation in subprime and "Alt-A" loans:

Subprime Loans

Participants in the mortgage market often characterize single-family loans based upon their overall credit quality at the time of origination, generally considering them to be prime or subprime. There is no universally accepted definition of subprime. The subprime segment of the mortgage market primarily serves borrowers with poorer credit payment histories and such loans typically have a mix of credit characteristics that indicate a higher likelihood of default and higher loss severities than prime loans. Such characteristics might include a combination of high LTV ratios, low credit scores or originations using lower underwriting standards such as limited or no documentation of a borrower's income. The subprime market helps certain borrowers by broadening the availability of mortgage credit.

While we have not historically characterized the single-family loans underlying our PCs and Structured Securities as either prime or subprime, we do monitor the amount of loans we have guaranteed with characteristics that indicate a higher degree of credit risk. See "Mortgage Portfolio Characteristics – Higher Risk Combinations" for further information. ***We estimate that approximately $6 billion and $3 billion of loans underlying our Structured Transactions at December 31, 2007 and 2006, respectively, were classified as subprime mortgage loans***. To support our mission, we announced in April 2007 that we will purchase up to $20 billion in fixed-rate and hybrid ARM products that will provide lenders with more choices to offer subprime borrowers. The products are intended to be consumer-friendly mortgages for

borrowers that will limit payment shock by offering reduced adjustable-rate margins, longer fixed-rate terms and longer reset periods than existing similar products. Subsequent to our announcement, we have entered into purchase commitments of $207 million of mortgages on primary residence, single-family properties specifically pursuant to this commitment. We also fulfill this commitment through purchases of refinance mortgages made to credit challenged borrowers, who may have previously been served by the subprime mortgage market. As of December 31, 2007, we have purchased approximately $43 billion of conventional mortgages made to borrowers who otherwise might have been limited to subprime products, including approximately $23 billion of refinance mortgages meeting our criteria.

With respect to our retained portfolio, at December 31, 2007 and 2006, we held investments of approximately $101 billion and $122 billion, respectively, of non-agency mortgage-related securities backed by subprime loans. These securities include significant credit enhancement, particularly through subordination, and 81% of these securities were AAA rated at February 25, 2008. During 2007, we recognized $10 million of credit losses as impairment expense on these securities related to four positions that were below AAA-rated at acquisition. The net unrealized losses, net of tax, on the remaining securities that are below AAA-rated are included in AOCI and totaled $504 million as of December 31, 2007. Between December 31, 2007 and February 25, 2008, credit ratings for mortgage-related securities backed by subprime loans with an aggregate unpaid principal balance of $16 billion were downgraded by at least one nationally recognized statistical rating organization. In addition, there were $5 billion of unrealized losses, net of tax, associated with AAA-rated, nonagency mortgage-related securities backed by subprime collateral that are principally a result of decreased liquidity in the subprime market. ***The extent and duration of the decline in fair value of these securities relative to our cost have met our criteria that indicate the impairment of these securities is temporary***. However, if market conditions continue to deteriorate, further credit downgrades to our non-agency mortgage-related securities backed by subprime loans could occur and may result in additional declines in their fair value.

Alt-A Loans

Many mortgage market participants classify single-family loans with credit characteristics that range between their prime and subprime categories as Alt-A because these loans have a combination of characteristics of each category or may be underwritten with lower or alternative documentation than a full documentation mortgage loan. Although there is no universally accepted definition of Alt-A, industry participants have used this classification principally to describe loans for which the underwriting process has been streamlined in order to reduce the documentation requirements of the borrower or allow alternative documentation.

We principally acquire Alt-A mortgage loans from our traditional lenders that largely specialize in originating prime mortgage loans. These lenders typically originate Alt-A loans as a complementary product offering and generally follow an origination path similar to that used for their prime origination process. ***In determining our***

exposure to Alt-A loans in our PC and Structured Securities portfolio, we have classified mortgage loans as Alt-A if the lender that delivers them to us has classified the loans as Alt-A, or if the loans had reduced documentation requirements which indicate that the loans should be classified as Alt-A. ***We estimate that approximately $154 billion, or 9%, of our single-family PCs and Structured Securities at December 31, 2007 were backed by Alt-A mortgage loans***. For these loans, our average credit score was 719, our estimated current average LTV ratio was 72% and our delinquency rate, excluding certain Structured Transactions, was 1.86% at December 31, 2007.

> We also invest in non-agency mortgage-related securities backed by Alt-A loans in our retained portfolio. ***We have classified these securities as Alt-A if the securities were labeled as Alt-A when sold to us or we believe the underlying collateral includes a significant amount of Alt-A loans. We believe that $51 billion and $56 billion of our single-family nonagency mortgage-related securities that are not backed by subprime loans are generally backed by Alt-A mortgage loans at December 31, 2007 and 2006, respectively***. We have focused our purchases on credit-enhanced, senior tranches of these securities and more than 99% of these securities were AAA-rated as of December 31, 2007. Between December 31, 2007 and February 25, 2008, credit ratings for mortgage-related securities backed by Alt-A loans with an aggregate unpaid principal balance of $1.1 billion were downgraded from AAA by at least one nationally recognized statistical rating organization.

* * *

Mortgage Portfolio Characteristics

As previously noted, all mortgages that we purchase for our retained portfolio or that we guarantee have an inherent risk of default. ***We seek to manage the underlying risk by adequately pricing for the risk we assume using our underwriting and quality control processes***. Our underwriting process evaluates mortgage loans using several critical risk characteristics, such as credit score, LTV ratio and occupancy type.

* * *

478. Later that morning, Defendants held an earnings conference call to discuss the Company's fourth quarter 2007 and full-year financial results. On the call, Defendants continued, consistent with their ongoing scheme, to insist that the Company's future prospects remained bright, that the Company's credit position was strong, and that its capital was sufficient. For example, Syron stated:

At the current level and surplus, management believes that we have sufficient capital to provide for modest growth in our business and to weather the downturn in the absence of significant further disruptions.

* * *

In addition to being timely, Freddie has taken a big step forward in enhancing the presentation of our financial results. ***As we have committed in the past, and many of you have asked, we'll continue to improve our financial reporting package by providing expanded disclosures and updating existing data with new information***.

* * *

479. Later in the call, Cook stated:

Although difficult to see in our financial results, the long-term prospects for both of our businesses are bright.

* * *

Finally, following our preferred issue in December, and the recent announcement by OFHEO that the portfolio cap will no longer be in place as of March 1st, we continue to manage our capital prudently to provide for reasonable growth in our business as well as maintain capital sufficiency through the current credit downturn.[43]

* * *

I want to address the ABS portfolio in a little more detail. The non-agency ABS were critical to our efforts to meet our affordable lending objectives and allowed us to invest in nonprime markets with substantial credit enhancement. ***Despite the continued deterioration of the housing market and increases in non-prime delinquencies, we remain comfortable with our risk position on these assets…***

* * *

Nonetheless, it remains true that the overall credit quality of our 2007 deliveries was worse than 2006 and the result of the GSE share, the overall market increasing primarily through the delivery of riskier loans. ***We believe this trend peaked in***

[43] OFHEO removed limits on the combined $1.5 trillion mortgage portfolios of Freddie Mac and Fannie Mac effective March 1, 2008. The asset caps, imposed in 2006 after the two companies revealed $11.3 billion of accounting errors, were lifted after Freddie Mac and Fannie Mae met a demand that they resume timely reporting by the end of the February 2008.

> ***November. While it is too early to claim victory, we have seen a meaningful improvement in the quality of our deliveries***.
>
> We have observed the improvement in our underlying loan quality by examining improvements in the worse quintile where a majority of the expected losses exist. Examples of these changes include, in January, loans with total LTVs greater than 90 percent declined 13 percent from the peak, FICOs less than 620 declined five percent and low and no dock loans declined 14 percent.
>
> ***Lastly, we must continue to manage capital responsibly as we consider various growth opportunities, particularly without the portfolio cap***.
>
> * * *
>
> ***So there you have it - from a business perspective, even in this difficult business environment, with house prices declining, expected default costs rising and risk premiums widening, we are increasingly able to improve the franchise value of the firm. We continue to benefit from a relatively strong credit risk position and market position. Our ABS portfolio has continued to demonstrate its resiliency to underlying subprime losses. We have taken steps to continue our mission and improve our business and we are experiencing pricing power and credit standard tightening in our g-fee and multifamily businesses. All of these business drivers will contribute to improved returns over the long term. With that, I'll turn it over to Buddy***.
>
> * * *

480. As the call went on, Piszel summarized the Company's financial position by stating:

> Thanks, Patti, and good afternoon, everyone. ***As [Syron] said, we intend to be a company that does what it says.*** From the finance side we've begun to demonstrate that in 2007 – we've improved our GAAP reporting and introduced our new non-GAAP framework, we've sunset the bulk of our control issues, we significantly expanded our disclosures, ***we don't have impairments on the ABS portfolio,*** and even with all of the additional work, we've returned to timely reporting. ***Lastly, our capital is about where we expected it following our preferred issuance in December. That's a lot of progress in one year and we'll continue down this track in 2008.*** We'll continue to accelerate our financial reporting timelines. We'll complete the strengthening of our control environment and become [an] SEC registrant. ***We said before that we aim to be a leader in disclosure and transparency and we've taken a number of actions today to continue our delivery on that commitment.*** We posted an enormous amount of information this morning with our release. Specifically, we provided new information on the house price path, our ABS portfolio and our new Adjusted Operating Income metric and results.

*   *   *

> So in summary, fourth quarter and full-year GAAP results continue to bear a lot of weight from credit expenses and mark-to-market items. ***On the positive side, our capital is intact and we've taken a number of important steps to relieve some of the pressure in '08.*** While we've tried to give you some idea for how these items will move in '08, we'll give you a fuller treatment to 2008 on our investor day in March. And that completes my discussion on fourth quarter and full year GAAP results.

*   *   *

481. Following Piszel's comments, Syron stated:

> ***I think maybe, most importantly, we think we're dealing with the situation in a prudent and responsible way.*** We're not at all claiming that the housing downturn is mostly done. On the contrary, we're assuming that house prices have fallen about one-third as far as they're going to go, peak to trough. That may [seem] pretty cautious or even pessimistic but I think cautious is exactly where you ought to want us to be right now. ***For all of these reasons, we believe that we will come out of the downturn in a strong, successful form as a competitor and in a sector whose longer-term demographics and growth prospects remain very good...***

*   *   *

482. During the question and answer session, Piszel also continued to mislead investors concerning the Company's capital adequacy, as demonstrated in the following exchange:

> **<u>Eric Wasserstrom – UBS Analyst</u>**
>
> Okay. And then just in terms of the loss expectations, can you talk a little bit about the expectation for reserves and whether more is needed as you look across your delinquency pipeline?
>
> **<u>Buddy Piszel – Freddie Mac – CFO</u>**
>
> Well, when you think about more is leading. GAAP is not providing for the reserves through the end of time. ***Our reserves cover right now about a year and a half worth of expected losses. The way those – we've laid out what the charge-offs are going to be, net of recoveries. You can see '08 is $1.7 billion, it goes up to $2.2 billion in 2010, pretty much the way we've modeled it so far, plateaus.***

*   *   *

483. Although the Company presented poor financial results on February 28, 2008, the focus the next day was on the Company's capital adequacy. Indeed, on February 29, 2008, *The Wall*

Street Journal published an article entitled "Credit Crunch: Freddie Posts Big Loss but Has Enough Capital," which stated, in part, "But Buddy Piszel, the chief financial officer, said in an interview that Freddie doesn't expect to need to raise capital again this year unless conditions get 'dramatically worse.' It raised $6 billion late last year through a sale of preferred stock."

484. In response to the February 28, 2008 Financial Report, related press release and conference call, and the comments reported on February 29, 2008, the price of Freddie Mac common stock dropped slightly from $25.09 on February 27, 2008 to a close of $24.49 on February 29, 2008, while the preferred shares fell as much as $1.60 per share. The next day, the common stock rose 2.8% to $25.18 per share on a day when the Dow Jones Industrial Average ("DJIA") was down more than 315 points, or 2.5 %. On the same day, the preferred shares increased as much as 2.1%. If not for Defendants' materially false and misleading statements, market expectations would have been corrected and the prices of the Company's equity securities would have fallen further on February 28, 2008, and would not have risen on February 29, 2008 when the rest of the market was falling.

485. The statements referenced in ¶¶472-82 were each materially false and misleading when made for the reasons set forth in ¶452 and the factual detail contained throughout this Complaint. In addition, the statements referenced in ¶¶472-82 were materially false and misleading when made because they represented and/or omitted adverse facts which then existed and disclosure of which was necessary to make the statements not false and/or misleading. The true facts, which were known to or recklessly disregarded by each of the Defendants, were:

- Defendants knew that, notwithstanding their Class Period statements that the turmoil in the credit and mortgage markets was presenting the Company with opportunities to profitably grow the Company's portfolios, that Defendants had, in fact, helped to create this turmoil, and in doing so, had taken on such an enormous amount of bad assets that the possession of these defaulting assets rendered these "opportunities" meaningless and illusory.

- Although Defendants touted the "quality of [Freddie Mac's] book of business," the truth was that Defendants refused to disclose that the Company had built market share with its high level of purchases of extremely risky subprime and other non-prime and non-traditional loans, which constituted almost 50% of the Company's 2007 purchases.

- The Company's book of business was anything but high quality. To the contrary, virtually all of the single family private MBS the Company purchased were not backed by investment grade loans – they were backed by Alt-A, subprime, and other default prone, non-prime and non-traditional loans. Indeed, during 2006 and 2007, ***100%*** of such purchases consisted of these non-prime and non-traditional loans. Also, during 2006 through 2007, Freddie Mac accounted for ***70%*** – or $120 billion – of the GSEs' subprime MBS purchases.

- Defendants knew that Freddie Mac had followed the market down, with the result being that 2007 was the Company's worst book of business ever in terms of objective credit risk characteristics. While Defendants described Freddie Mac as having a strong foundation for the future, this foundation, as Defendants knew, was fatally flawed, as it was built on $628.5 billion in subprime, Alt-A and other default prone loans and subprime and Alt-A MBS, amounting to 32% of the Company's credit risk exposure.

- Defendants knew, based on information identified in, among other things, the August 2007 risk report, that Freddie Mac's loans from 2005 through 2007 had significantly worse default rates than prior years, and that these defaults rates threatened the viability of the Company.

- By early 2008, the key risk indicators and critical thresholds identified and included in the August 2007 risk report had been reached. Although the Company was supposed to enact plans to ensure mitigation of the risks associated with these events, Defendants did nothing to address or remedy those material weaknesses that were a then-existing threat to the Company's viability. Therefore, as Defendants knew, their statements regarding the adequacy of Freddie Mac's capital were not substantiated. In the words of one knowledgeable confidential witness, Defendants' statements were "bulls**t."

- Defendants' statements concerning the "temporary" impairment to the fair value of its securities were dependent on violations of GAAP, and overstated the Company's net income and regulatory capital surplus during the Class Period. Defendants lacked a reasonable basis for stating the Company did not have impairments in its ABS portfolio, and such statements were misleading to the market. As Defendants knew, there were numerous factors in existence at the time of their statements indicating that it was probable Freddie Mac would not collect all amounts due on its ABS subprime and Alt-A investments in accordance with their contractual terms. This likelihood rendered these investments impaired, and the Company should have recognized significant financial impairments. These facts further undermined Defendants' statements concerning the adequacy of Freddie Mac's capital.

486. In a March 3, 2008 Foxx-Pitt analyst report titled, "Are Market Risk Perceptions Overstated," Foxx-Pitt noted that the conclusion of Freddie Mac's analysis of its subprime and Alt-A exposure ***"ought to be reassuring to investors."*** The Foxx-Pitt analyst report went on to note that:

> ***[u]nder conservative scenario analysis, FRE's ABS portfolios should experience immaterial levels of loss, so there are unlikely to be significant demands on capital from other-than-temporary impairment***.

487. Notwithstanding Defendants' positive spin, following issuance of the February 28, 2008 Financial Report, press release, and conference call, potential problems at Freddie Mac began being heavily discussed in the market, causing its common stock to drop from a close of $25.18 on February 29, 2008 to a close of $17.39 on March 10, 2008, with the Company preferred stock dropped as much as $7.30 per share. During that timeframe articles were being published speculating on the problems surrounding the Company:

(a) For example, on March 6, 2008, the *Associated Press* published an article entitled, "Fannie Mae, Freddie Mac shares sink as [federal government] denies rumor of formal government backing." The article stated, in part, that shares in the Company were falling after "the Treasury Department denied rumors that the government would formally back the two companies and a report showed the foreclosures continued to soar," with a Treasury department spokeswoman saying a rumor of government promise to support Freddie Mac if its finances further deteriorated was "absolutely not true."

(b) Over the March 8-9, 2008 weekend, *Barron's* published an article questioning whether Freddie Mac and Fannie Mae would be "The Next Government Bailout?"

(c) On March 10, 2008, the *Associated Press* published an article reporting Company's shares had fallen to a 52-week low on the heels of the *Barron's* article, but that "investment firm Bear Stearns Cos., in a research note Monday, said the article lacked a 'complete or balanced picture' of the company's finances." The article also noted Company shares fell after the

Treasure Department denied market rumors the government would formally back Freddie Mac's finances.

488. On March 11, 2008, however, Defendants' false and misleading statements again took hold and overcame the recent decline in the prices of its equity securities (which would have been deeper but for Defendants' fraud) and began to artificially inflate the price of the Company's common stock at a rapid pace. On that date, the common stock price rapidly climbed nearly 16% from a close of $17.39 on March 10, 2008 to a closing price of $20.16, while the price of the Company's preferred shares rose by as much as $4.50 per share. Specifically, duped by Defendants' false and misleading statements, OFHEO said in a statement reported on by *Reuters* that Freddie Mac had adequate capital.

489. On March 12, 2008, Freddie Mac held an investor/analyst conference wherein Defendants continued to mislead the market regarding the Company's financial strength:

> **Richard Syron – Freddie Mac Chairman, CEO**
>
> Clearly, our results have been very, very heavily affected by the economy, ***but it is important and you will see this later on to recognize that a lot of our results are as much affected by accounting conventions as they are by economic realities***. It is a tough environment. What have we done about it? Seems to me that's where we got to start. We've got to start with what have we done about it and then what we are going to do going forward. First thing we did is we took very decisive steps to raise capital at the end of last year. At the end of last year, we looked at our capital need, we said what should we do.
>
> * * *
>
> We were the first in line and we were followed by lots of other people in our successful capital raise. ***Maybe going forward what is equally important is we have adjusted our pricing and credit quite substantially to align more closely with risk…***
>
> * * *
>
> ***We are trying to deal with the current situation in a way that is both prudent and responsible; responsible in terms of our obligations to the economy as a whole, but very much responsible in terms of our obligations to our shareholders because, at***

the end of the day, we are a shareholder-owned corporation and we have a legal and fiduciary responsibility to you on that.

* * *

Even in this bad time, we feel very strongly about the comparative strength of our book of business. We think it's among the best in the industry. It is a tough book overall but within that book we think we are about the best in the industry. Compared to our competitors, our mortgage portfolio is low in loan-to-value, low in holdings of exotic loans, high in regional diversification and high in credit quality.

* * *

490. Later on the conference call, Piszel stated, in part:

So, where do we stand on capital? Well, for starters, on January 2nd, after adopting the fair value option, our capital stood at approximately $39 billion with an estimated surplus over the 30% of $4.5 billion.

I might add that this is twice the surplus we had over the 30% starting out in '07, and it is about $12.4 billion over the minimum capital requirement. ***So we started out the year approximately where we thought we would be and that is really good news*** given the degree to which declining long-term interests rates hurt our fourth quarter GAAP results.

* * *

So, lower interest rate exposure. Categorically no deferred tax write-offs. And then, you will hear in the next session, we are still very confident in our ABS impairment exposure. ***You put all that together and you add the actions that we took to reduce the volatility, exposure we had from credit marks, and the net result is that we are in a much better position to manage our capital in 2008 than we were in 2007.***

* * *

491. As the conference call continued, Cook misled the market by stating that Freddie Mac was different from other companies hit hard by the economic downturn, stating in part:

These are really unbelievable times, aren't they? The severe deterioration in housing prices and residential mortgage credit quality that we've experienced in the last nine months is truly unprecedented. And as you can imagine, as a $2.5 trillion mortgage company, we have clearly been impacted by this trend. ***Unlike many other companies though, Freddie Mac has the financial strength, access to financing, and risk management practices that will enable us to weather the storm and emerge as a more profitable Company in the future.***

Specifically, our strengthened competitive position, significant improvements in the underlying asset quality and the higher pricing on our new business should provide a base for future profitability as we emerge from the current downturn.

While there have been some tough moments in the past several months, the opportunities that are presenting themselves to us continue to keep us enthusiastic about the opportunities to grow shareholder value over the long-term.

*   *   *

Freddie Mac's asset quality is high by industry standards and is improving with our new business volumes … Freddie Mac's strong credit, interest rate, and counterparty credit risk management practices should limit our downside.

*   *   *

One strength of Freddie Mac over the long term has been the strong underlying credit quality of the guarantee business and retained portfolios. This trend has continued in 2007 and is only increasing in 2008.

In the single family business, we have provided the market with a listing of our credit attributes on our guarantee portfolio with each of our recent earnings releases, ***but, the high level point is that due to our relatively low exposure to Alt-A, subprime, low FICO and high LTV loans, our serious delinquency rate, expected default costs, and recent period charge-off amounts have all been the lowest in the industry***.

*   *   *

Finally, inside our own portfolio, we have benefited from the shifts in our own tighter underwriting standards. In January, loans with LTVs greater than 90% declined 13% from their peak; FICO's less than 620 declined 5% from their peak; and low and no doc loans declined 9%.

*   *   *

In the retained portfolio, the credit quality of our retained portfolio remains very high…

Despite the continued deterioration of the housing market and increases in non-prime delinquencies, we remain comfortable with our risk position on these assets. Remember, to the end of 2007, we have recorded no credit related impairments on these funds, and we have no CDO exposure. ***While we remain very comfortable with our asset-backed portfolio***, given the lack of new issuance in the private label market, most of our recent purchases in the portfolio have been in agency-guaranteed securities.

*   *   *

Over time, Freddie Mac has succeeded in large part due to the strength of our risk management practices. We have successfully managed interest rate, pre-pay and complexity risk through many market cycles.

We have managed our credit risk relatively well, creating a portfolio that is one of the best in the industry. And while the markets are likely to remain challenging for us over the next few quarters, we remain confident in our ability to manage through it. So, let me close by reiterating the difficulty and challenges posed by the current environment. Losses are certainly larger than one would have predicted a year ago as the housing market has performed much worse.

And yet, as a result of this experience and our current position as the preferred liquidity provider, it has allowed us to raise fees and tighten terms of business. We are able to deploy capital at very attractive returns. ***So, while we absorb and realize the losses of the existing book of business, we are building a strong book for the future***.

* * *

<u>Peter Federico - Freddie Mac - SVP - Asset & Liability Management</u>

So, with that, I will go to slide one. Let me begin with our current credit profile. ***On a positive note, our credit profile is beginning to show signs of improvement. Over the last several months, we have seen improvement in many of the key credit risk variables. This is certainly a positive development and a direct result of the positive and proactive steps we have taken to manage through this difficult credit cycle***.

Some of the improvement can be seen on this slide. Without question, the overall credit quality of our 2007 book was worse than the deliveries we received in 2006. ***We believe, however, that this trend peaked in October. And since then, we have begun to see improvement, specifically as you could see from this slide, we are seeing a meaningful improvement in the credit quality of the worst quintile of our deliveries***. We focus on this quintile because it is the most significant driver of our credit losses. In January, for example, as Patti mentioned, loans in this quintile with FICO scores less than 620, declined 5%. Similarly, loans with loan to value ratios greater than 90% declined 13%. Reduced documentation loans declined 9% and loans with secondary financing declined 14%.

* * *

<u>Gary Kain – Freddie Mac SVP Investments & Capital Markets</u>

First, our affordable housing goals mandate that a high percentage of our purchases are targeted toward borrowers represented in the non prime sector. Secondly, we were not comfortable with the risk of buying or guaranteeing these loans outright. Lastly, we believe that purchasing securities backed by these loans at the AAA level with substantial credit enhancements would produce reasonable returns in the least risky way possible.

*   *   *

Second, as discussed in more detail in the white paper, our subprime securities are considerably shorter than those backing the ABX index and therefore materially safer. Third, essentially all of Freddie Mac's ABS securities are classified "as available for sale." This is another key distinction. As a result, changes in the mark-to-market values do not impact GAAP net income or regulatory capital unless we deem these securities to be "other than temporarily impaired." Freddie Mac has not recorded any impairment on its portfolio of ABS securities in 2007.

We do not identify any individual securities in the portfolio where principal losses or interest shortfalls were probable. Since the Company has both the intent and the ability to hold these securities until maturity, impairments were not required. Said another way, we believe that unrealized losses on the ABS portfolio as of December 31, 2007, are principally the result of significant increases in market risk premiums and diminished liquidity.

*   *   *

[W]e feel the bulk of the 2006 book is also well positioned to withstand further deterioration in market conditions...

*   *   *

[D]espite the continued deterioration of the housing market and increases in non-prime delinquencies for the reasons discussed, we remain comfortable with our exposure to these assets…

*   *   *

492. On the same call, Romano stated that Freddie Mac was "far away" from taking any impairments in the Company's asset-backed securities portfolio"

Unidentified Audience Member

I have got a question, well, on the topic of impairments. Can you talk a little bit about the process that you would go through in discussing potential impairments with your auditors, because you might say well we don't think it's probable, but somebody else might have a different opinion and we do know that Fannie Mae I guess a few years ago had some discussions with OFHEO about their process for taking impairments on aircraft leases and other securities.

So, if there is a disagreement or a question about whether the cash flow modeling does result in probable or possible losses, can you talk about rating downgrades in market pricing securities and time periods and how those would enter into the discussions with the auditor?

<u>Ray Romano – Freddie Mac SVP of Enterprise Risk Oversight</u>

> Yes, let me take the question if I can get miced. This process starts out when you do look at where rating agencies are going, you look at where market prices are going, and that's how you focus on the things that have a potential for it. So, that's where you start from. And then you say, well, now you have to evaluate wherever you think you are going to lose money. And so, we have been -- we don't just do our impairment test or loans under stress. We could have for every security in the portfolio.
>
> If you go through the analysis that Gary just walked through and then we engage, we sat down with our auditors on every single security to walk them through why we believe based on what's happened so far CE is where the delinquencies are and the defaults have been so far, the remaining coverage and the build up of coverage that there is nothing imminent. And there were no points of contention, none. ***Now, as you go further and further into the defaults getting closer to your CE, at some point, you could reach a conclusion that there is probability. For at least at this point of time, we are so far away from that. There were just no close, there were no close calls***.

* * *

493. The market paid close attention to Defendants' and Company executives' comments on March 12, 2008. As demonstrated above, Defendants' plan to hide the truth regarding the Company's exposure to declines in then on-prime mortgage market and misrepresent capital adequacy worked. Indeed, the *Associated Press* reported Freddie Mac "has enough capital and will not need to dilute the value of its shares by issuing more stock," quoting Piszel as saying, "there is no dilutive capital raising planned." Similarly, *Reuters* reported that same day that "Freddie Mac earnings should improve by a 'good margin' this year and it has enough capital to weather the worst housing market in a century." The *Reuters* article also reported that after the conference, Morgan Stanley analyst Kenneth Posner improved his forecast for Freddie Mac's first quarter by 56% to a loss of 63 cents a share from $1.44, and that in response to the Federal Reserve and the U.S. Treasury urging Freddie Mac to raise capital, Syron stated, ***"[t]his company will bow to no-one on our responsibility to the shareholders***."

494. Demonstrating the persuasiveness with which the market accepted Defendants' false and misleading statements as the gospel truth, following the March 12, 2008 analyst conference, Bear Stearns provided investors with the following comments about the Company's future:

> ***We came away from the meeting more optimistic about the company's ability to weather the current housing downturn. The company is unlikely to have significant losses on private-label securities, will benefit from tighter underwriting standards and higher prices, won't be issuing common stock that dilutes shareholders to appease regulators/politicians, and has ample taxable income to take advantage of tax losses***.

495. On that same day, a Foxx-Pitt analyst report upgraded its rating of Freddie Mac and stated that ***"FRE's capital position appears sound."***

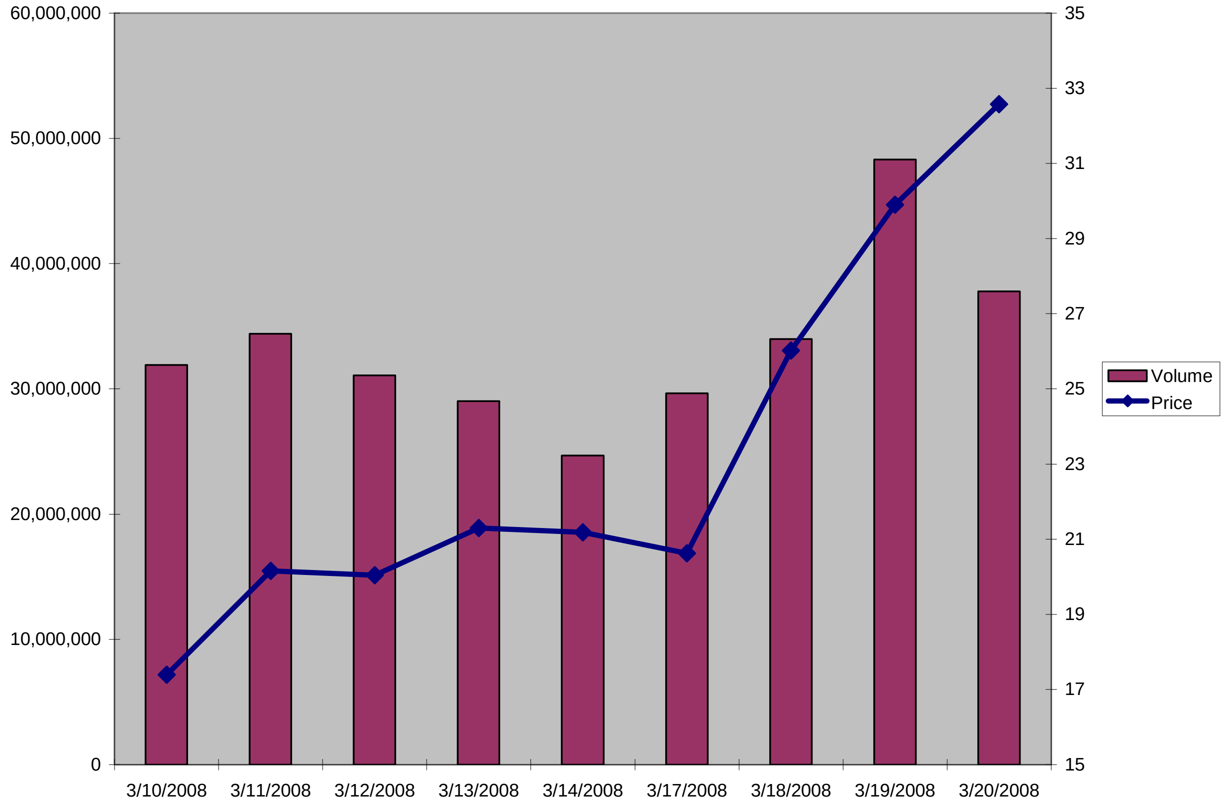
496. On March 13, 2008, Defendants' spin that the Company would not seek to raise additional capital continued to reach the market. For example, the *Washington Post* reported "Freddie Mac, the giant mortgage-funding company, sent a fresh signal yesterday that it won't compromise the interests of its shareholders to increase its capacity to help the troubled housing market by buying or guaranteeing mortgages." The article continued, "Chief financial officer Anthony S. Piszel made the point repeatedly for emphasis, using the jargon of Wall Street: '***There is no dilutive capital raise planned***'" and Syron pointed out, "***We think we have enough***."

497. In response to false and misleading statements referenced in ¶¶489-93, 496, the trading price of Freddie Mac common stock was artificially inflated. For example, it rose 15% from $17.39 on March 10, 2008 to $20.16 on March 11, 2008. Likewise, Freddie Mac preferred shares rose by as much as 14%. Freddie Mac common stock then rose nearly 6% to $21.20 on March 13, 2008, with the preferred shares rising as much as 2%. On March 18, 2008, Freddie Mac common stock rose again, closing at $26.02, up 23.3% from the day before, and the preferred shares rose as much as 14%, as *Reuters* reported that "Freddie Mac shares jump on capital hope" and that

Company shares "notched their ***biggest one-day gains in two decades*** on Tuesday on expectations the government will allow the housing finance companies to expand their roles in the ailing U.S. housing market" by relaxing capital surplus requirements. On March 19, 2008, the trading price of Freddie Mac common shares climbed yet again, gaining an additional 15% to close at $29.90, and its preferred shares rose by as much as 11%, as the *DowJones* reported OFHEO had reduced Freddie Mac's capital surplus from 30% to 20% and the *PR Newswire* reported:

> OFHEO announced that it would begin to permit a significant portion of the GSEs' 30 percent OFHEO-directed capital surplus to be invested in mortgages and MBS. As a key part of this initiative, both companies announced that they will begin the process to raise significant capital. Both companies also said they would maintain overall capital levels well in excess of requirements while the mortgage market recovers in order to ensure market confidence and fulfill their public mission.

498. On March 20, 2008, Company common shares rose an additional 9% to close at $32.58, with its preferred shares rising as much as 14%, as *Reuters* reported market analysts from Keefe, Bruyette & Woods upgraded Freddie Mac to "outperform" from "market perform" while citing to recent government actions to reduce the mandated excess capital requirement. All told, common stock saw marked gains of approximately ***72%*** from March 10-20, 2008, in response to Defendants' materially false and misleading statements, which were repeated in news articles and accepted as true by financial analysts, concerning the Company's capital adequacy, as demonstrated in the chart below:



499. The statements referenced in ¶¶489-93 and 496 were each materially false and misleading when made for the reasons set forth in ¶452 and the factual detail contained throughout this Complaint. In addition, the statements referenced in ¶¶489-93 and 496 were materially false and misleading when made because they represented and/or omitted adverse facts which then existed and disclosure of which was necessary to make the statements not false and/or misleading. The true facts, which were known to or recklessly disregarded by each of the Defendants, were:

- Although Defendants touted the "comparative strength of [Freddie Mac's] book of business," the truth was that Defendants continued to refuse to disclose that the Company had built market share with its high level of purchases of extremely risky subprime and other non-prime and non-traditional loans, which constituted almost 50% of the Company's 2007 purchases.

- The Company's book of business was anything but high quality. To the contrary, virtually all of the single family private MBS the Company purchased were not backed by investment grade loans – they were backed by Alt-A, subprime, and other default prone, non-prime and non-traditional loans. Indeed, during 2006 and 2007, ***100%*** of such purchases consisted of these non-prime and non-traditional loans.

Also, during 2006 through 2007, Freddie Mac accounted for ***70%*** – or $120 billion – of the GSEs' subprime MBS purchases.

- Once again, Defendants misled investors through the use of generalities and vague comparisons to other companies to give the market the impression there was a "strong underlying credit quality of the guarantee business and retained portfolio." Defendants made no mention, however, of the fact that 29% of the Company's exposure was to high risk subprime and non-prime loans and that these risks increased measurably in 2008, which, when combined with Freddie Mac's high leverage, would lead to it becoming effectively bankrupt within six months.

- The Company was experiencing a massive diminution in the value of its subprime and Alt-A investments at this time, and the key risk indicators and triggers identified in the August 2007 risk report had become a reality. Increasing defaults and delinquencies on subprime and non-prime mortgage loans were causing the values of the Company's securities to decline at an alarming rate. Despite their knowledge that the Company was experiencing high levels of delinquencies and defaults, in violation of SFAS No. 115, Defendants failed to record an other than temporary impairment to its subprime and non-prime securities.

- Between December 31, 2007 and February 25, 2008, the credit ratings associated with more than $16 billion of Freddie Mac's AAA-rated securities backed by subprime loans – or more than 15% of such portfolio – were downgraded below AAA. In less than 60 days, more than 17% of Freddie Mac's AAA subprime investments were downgraded. This was a red flag waving in Defendants' faces that its investment securities had suffered at least a $10 billion other than temporary impairment. Thus, Defendants' statements regarding the quality of its book of business and adequacy of capital were false and misleading when made.

- Defendants knew their purported credit enhancements were not operating effectively and would not be sufficient to protect the Company against impairment losses. Despite this fact, Defendants continued to tout the Company's supposed "risk management practices." Defendants' statements that the Company was "comfortable with [its] risk position" lacked a reasonable basis.

- Defendants did not disclose that their highly misleading omissions and refusal to record impairments to the Company's finances were nothing more than a misleading shell game designed to preserve the Company's scant financial capital.

500. On March 28, 2008, *Reuters* published an article entitled, "OFHEO: Fannie, Freddie may raise $20 bln," which described an interview in which Lockhart, the director of OFHEO, stated that OFHEO would allow Freddie Mac and Fannie May to raise as much as $20 billion in capital as part of an agreement to let the companies buy more debt securities, and that the

capital could take the form of common shares, preferred shares, or convertible preferred shares. The article went on to report that "On March 19, OFHEO lowered the capital threshold to 20 percent from 30 percent, allowing Fannie Mae and Freddie Mac to buy up to $200 billion of mortgage-backed securities and help support a shaky market for housing and home loans," and that Freddie Mac had to raise the $20 billion before OFHEO would approve a further cut in the Company's capital surplus requirements.

501. Within hours of OFHEO's and Lockhart's statements that Freddie Mac had to raise a substantial amount of additional capital, Freddie Mac and Syron went on the defensive in an effort to mislead the market as to the soundness of Freddie Mac's capital position and minimize the impact of OFHEO's pronouncement. On March 28, 2008, the *Associated Press* released an article entitled, "Freddie disputes regulator's estimates of new capital to be raised by mortgage finance giants," which reported that ***"[i]n a statement Friday, Richard Syron, Freddie Mac's chairman, said that according to a verbal agreement made in recent weeks, the companies would raise $1 in new capital for each dollar by which their capital reserves had been reduced*** " and that ***Syron stated "'Freddie Mac's understanding. . . is that any additional capital raised would be consistent with the dollar amount of the reduction in the OFHEO-directed capital surplus from 30 percent to 20 percent***.'"

502. Between the end of March 2008 and May 2008, the Company's shares hovered around $25 per share as news continued to reach the market concerning the fact that OFHEO was requiring the Company's to raise additional capital. It was reported that Company management, compensated partly on stock performance, was reluctant to raise more equity because of dilution concerns.

503. The statements referenced in ¶501 were each materially false and misleading when made for the reasons set forth in ¶452 and the factual detail contained throughout this Complaint. In addition, the statements referenced in ¶501 were materially false and misleading when made because they represented and/or omitted adverse facts which then existed and disclosure of which was necessary to make the statements not false and/or misleading. The true facts, which were known to or recklessly disregarded by each of the Defendants, were:

- The Company's core capital was overstated by ***at least*** $10 billion due to the Company's improper refusal to record an other-than-temporary impairment in the value of its AFS securities.
- By this time, nearly 50% of the Company's core capital was attributable to the Company's deferred tax asset, for which the Company should have recorded a valuation allowance and concomitant charge against earnings, which would have revealed the Company's true capital inadequacy.
- Due to the clear manifestation of key risk indicators and triggers identified in the Company's August 2007 risk report – about which nothing was being done – Defendants' statements concerning the adequacy of the Company's capital were lies intended to mislead investors.

504. On the morning of May 14, 2008, Freddie Mac issued its Financial Report for the Three Months Ended March 31, 2008 (the "May 14, 2008 Financial Report") and an accompanying press release. The press release stated, in pertinent part:

> McLean, VA – Freddie Mac (NYSE:FRE) today reported a net loss of $151 million, or $0.66 per diluted common share, for the quarter ended March 31, 2008, compared to a net loss of $133 million, or $0.35 per diluted common share, for the quarter ended March 31, 2007. The company reported a net loss of $2.5 billion, or $3.97 per diluted common share, for the fourth quarter of 2007.
>
> "Market and credit conditions remained challenging during the first quarter of 2008," said Richard F. Syron, chairman and chief executive officer. "This stress is particularly evident in our increased credit-related expenses. However, ***Freddie Mac on the whole had a better first quarter than what we experienced in the third and fourth quarters of last year,*** which were significantly impacted by credit and interest rate related marks. ***We showed strong momentum in market share, business volumes, margins and total revenue.***

"In this trying time for our housing market, and the economy as a whole, I am especially pleased that our company continues to serve its mission by being a consistent, reliable provider of affordability, liquidity and stability to the nation's housing financing system," Syron continued. "Among many other things, we're serving this vital role by using the new authority provided by Congress to support the jumbo mortgage market, making a meaningful and positive impact on spreads in the MBS market and exploring constructive and creative ways to work out loan modifications for distressed homeowners.[44]

"In the near future, we plan to raise $5.5 billion in new core capital," Syron added. ***"We are already deploying our available capital to make the most of the excellent opportunities we see in the current market, which will serve our mission at a time when most sources of liquidity for the struggling housing sector have dried up. This additional, fresh capital will enable us to do even more to serve our mission and build long-term, durable shareholder value."***

"Throughout the first quarter, Freddie Mac struck a careful balance of managing risk and seizing business opportunities," said Buddy Piszel, chief financial officer. ***"We continued to make prudent provision for credit losses, monitor our credit book closely and maintain our disciplined approach to managing interest-rate and other risks. Our credit guarantee business saw strong, high quality growth – and as the quarter ended, we also were able to significantly ramp up our mortgage purchase commitments for the retained portfolio.***

"It's important to note that we began the year with a larger capital cushion compared to a year earlier, and during the quarter we put that capital to work, providing critically needed liquidity to the market and delivering attractive returns on equity for our business," Piszel said. "Our plan is to raise new capital that will not only enable us to continue to serve our mission and meet the housing market's needs in this time of stress, but also to deploy that capital in a way that enhances business flexibility and strengthens our capital position.

"We also made progress on a number of other important fronts, including beginning our registration process with the Securities and Exchange Commission and completing our remediation of all the previously identified material weaknesses in our controls environment," Piszel added. ***"While our expectation is for continued weakness in the housing and economic environment to negatively impact our overall performance through the remainder of this year, we have put Freddie Mac on a better foundation to manage through the current cycle and emerge a successful, long-term competitor."***

[44] In April 2008, Congress temporarily raised the upper limit in high-cost areas for both Freddie Mac and Fannie Mae to purchase conforming jumbo mortgages from $417,000.00 to $729,750.00.

*   *   *

Net loss for the first quarter of 2008 was $151 million, compared to a net loss of $2.5 billion in the fourth quarter of 2007. ***Improved results reflect reduced losses related to a change in the guarantee obligation valuation methodology implemented under SFAS No. 157, "Fair Value Measurements" (SFAS 157), which better aligns revenue recognition with the economic release from risk under the guarantee.*** As a result, effective January 1, 2008, the company no longer records estimates of deferred gains or immediate losses recognized upon issuances of single-family Mortgage Participation Certificates (PCs) and Structured Securities in guarantor swap transactions through losses on certain credit guarantees, a component of non-interest expense. In the fourth quarter of 2007, the company incurred $1.3 billion in losses on certain credit guarantees.

Improved results also reflect lower interest-rate related mark-to-market losses as a result of the company's adoption of SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115" (SFAS 159). Effective January 1, 2008, the company elected the fair value option for certain available-for-sale mortgage-related securities and its foreign-currency denominated debt. Upon adoption of SFAS 159, the company recognized a $1.0 billion after-tax increase to its beginning retained earnings at January 1, 2008. See the Appendix for more detail on the adoption of SFAS 157 and SFAS 159.

In addition, during the first quarter, the company recorded strong revenue growth in the guarantee business mostly due to growth in the average balance of issued PCs and Structured Securities, which was offset by higher credit-related expenses as higher loan loss severities and serious delinquency rates resulted in increases in provision for credit losses and real estate owned (REO) operations expense.

*   *   *

Core Capital

Estimated regulatory core capital was $38.3 billion at March 31, 2008, which represented an estimated $11.4 billion in excess of the company's statutory minimum capital requirement, and an estimated $6.0 billion in excess of the 20 percent mandatory target capital surplus directed by the Office of Federal Housing Enterprise Oversight (OFHEO). During the first quarter of 2008, the company added approximately $0.5 billion to core capital due primarily to the $1.0 billion impact of adopting SFAS 159, partially offset by dividend payments of $0.4 billion and the net loss of $0.2 billion for the quarter.

The company expects to raise $5.5 billion of new core capital in the near future through one or more offerings, of which $2.75 billion may consist of common stock and $2.75 billion may consist of non-convertible preferred securities. The timing, amount and mix of securities to be offered will depend on a variety of factors,

including near-term prevailing market conditions and the company's SEC registration process, and is subject to approval by Freddie Mac's Board of Directors.

OFHEO has informed the company that, upon completion of these offerings, the mandatory target capital surplus will be reduced from 20 percent to 15 percent. OFHEO has also informed the company that it intends a further reduction of the mandatory target capital surplus from 15 percent to 10 percent upon completion of its SEC registration process, the company's completion of the remaining Consent Order requirement (*i.e.*, the separation of the positions of Chairman and Chief Executive Officer), the company's continued commitment to maintain capital well above OFHEO's regulatory requirement and no material adverse changes to ongoing regulatory compliance. The company reduced the dividend on its common stock in December 2007, and does not currently anticipate further decreases in dividend payments.

* * *

505. The May 14, 2008 Financial Report 55 contained a section entitled, "Credit Risks," wherein the Company discussed its underwriting requirements and quality control standards:

Mortgage Credit Risk

Mortgage credit risk is primarily influenced by the credit profile of the borrower on the mortgage, the features of the mortgage itself, the type of property securing the mortgage and the general economic environment. To manage our mortgage credit risk, we focus on three key areas: underwriting requirements and quality control standards; portfolio diversification; and portfolio management activities, including loss mitigation and the use of credit enhancements.

All mortgages that we purchase for our retained portfolio or that we guarantee have an inherent risk of default. ***We seek to manage the underlying risk by adequately pricing for the risk we assume using our underwriting and quality control processes***. Our underwriting process evaluates mortgage loans using several critical risk characteristics, such as credit score, LTV ratio and occupancy type.

Underwriting and quality control standards

We use a process of delegated underwriting for the single-family mortgages we purchase or securitize. ***In this process, we provide originators with a series of mortgage underwriting standards and the originators represent and warrant to us that the mortgages sold to us meet these requirements. We subsequently review a sample of these loans and, if we determine that any loan is not in compliance with our contractual standards, we may require the seller/servicer to repurchase that mortgage or make us whole in the event of a default***. In response to the changes in the residential mortgage market during the last year, we have made changes to our

underwriting guidelines during the first quarter of 2008, which our seller/servicers must comply with for loans delivered to us for purchase or securitization. In February 2008, we announced that effective June 1, 2008 we would sharply reduce our purchases of mortgages with LTV ratios over 97%, subject to exceptions for Home Possible mortgages with higher borrower credit scores and certain mortgages with federal insurance or guarantees. Our Home Possible program is designed to help finance first-time homebuyers by allowing lower loan requirements for those meeting the eligibility criteria. We also provided guidance on our pre-existing policy that maximum LTV ratios for many mortgages must be reduced in markets where home prices are declining. In some cases, binding commitments under existing customer contracts may delay the effective dates of underwriting adjustments.

* * *

506. The "Credit Risks" section also contained a discussion on Freddie Mac's participation in subprime and "Alt-A' loans:

Subprime Loans

Participants in the mortgage market often characterize single-family loans based upon their overall credit quality at the time of origination, generally considering them to be prime or subprime. There is no universally accepted definition of subprime. The subprime segment of the mortgage market primarily serves borrowers with poorer credit payment histories and such loans typically have a mix of credit characteristics that indicate a higher likelihood of default and higher loss severities than prime loans. Such characteristics might include a combination of high LTV ratios, low credit scores or originations using lower underwriting standards such as limited or no documentation of a borrower's income. The subprime market helps certain borrowers by broadening the availability of mortgage credit. While we have not historically characterized the single-family loans underlying our PCs and Structured Securities as either prime or subprime, we do monitor the amount of loans we have guaranteed with characteristics that indicate a higher degree of credit risk (see "Higher Risk Combinations" for further information). ***In addition, we estimate that approximately $4 billion of security collateral underlying our Structured Transactions at both March 31, 2008 and December 31, 2007 were classified as subprime***.

With respect to our retained portfolio, at March 31, 2008 and December 31, 2007, we held investments of approximately $93 billion and $101 billion, respectively, of non-agency mortgage-related securities backed by subprime loans. These securities include significant credit enhancement, particularly through subordination, and 70% and 96% of these securities were AAA-rated at March 31, 2008 and December 31, 2007, respectively. The unrealized losses, net of tax, on these securities that are below AAA-rated are included in AOCI and totaled $5 billion and $504 million as of March 31, 2008 and December 31, 2007, respectively. In addition, there were $6 billion of unrealized losses, net of tax, included in AOCI on

these securities that are AAA-rated, principally as a result of decreased liquidity and larger risk premiums in the subprime market. We receive substantial monthly remittances of principal repayments on these securities, which totaled more than $8 billion during the first quarter of 2008.

Our evaluation of securities for other than temporary impairment contemplates numerous factors. We perform an evaluation on a security-by-security basis and consider factors such as the length of time and extent to which the fair value has been less than book value; the near term prospects of the issuer of a security, the impact of changes in credit ratings (*i.e.*, rating agency downgrades), and cash flow analysis based on default and prepayment assumptions; and our intent and ability to hold the security for a period of time sufficient to allow for an anticipated recovery in fair value. Based on the results of our analyses, if we determine that a decline in fair value is other than temporary, the carrying value of the security would be written down to its fair value, and a loss would be recognized through earnings. We consider all available information in determining the recovery period and anticipated holding periods for our available-for-sale securities. As a portfolio investor, we generally hold our available-for-sale securities to maturity. An important underlying factor we consider in determining the period to recover unrealized losses on our available-for-sale securities is the estimated life of the security. Since most of our available-for-sale securities are prepayable, the average life is shorter than the contractual maturity. We believe the declines in fair values for most of these securities have been due to decreased liquidity and larger risk premiums in the subprime market. ***The results of our cash flow analyses indicate that while it is possible that under certain conditions, defaults and severity of losses on these securities could exceed our subordination and credit enhancement levels and a principal loss could occur, we do not presently believe that those conditions are probable. As a result of our reviews, we have not identified any securities in our available-for-sale portfolio that are probable of incurring a contractual principal or interest loss. Based on our ability and intent to hold our available-for-sale securities for a sufficient time to recover all unrealized losses and our consideration of all available information, we have concluded that the reduction in fair value of these securities is temporary at this time***. However, if there is a subsequent deterioration of the individual performance of any of these securities, or if market conditions lead us to change our expectations relating to future performance, we could determine that impairment charges are warranted.

* * *

On December 6, 2007, the American Securitization Forum, or ASF, working with various constituency groups as well as representatives of U.S. federal government agencies, issued the Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime ARM Loans, or the ASF Framework. The ASF Framework provides guidance for servicers to streamline borrower evaluation procedures and to facilitate the use of foreclosure and loss prevention efforts in an attempt to reduce the number of U.S. subprime residential mortgage borrowers who might default during 2008 because the borrowers cannot afford the increased payments after the interest

rate is reset, or adjusted, on their mortgage loans. The ASF Framework is focused on subprime, first-lien, ARMs that have an initial fixed interest rate period of 36 months or less, are included in securitized pools, were originated between January 1, 2005 and July 31, 2007, and have an initial interest rate reset date between January 1, 2008 and July 31, 2010 (defined as "Subprime ARM Loans" within the ASF Framework). We have not applied the approach in the ASF Framework and it has not had any impact on the off-balance sheet treatment of our qualifying special-purpose-entities that hold loans meeting the related Subprime ARM Loan criteria. Under the ASF Framework, Subprime ARM Loans are divided into the following segments:

- Segment 1 – those where the borrowers are expected to refinance their loans if they are unable or unwilling to meet their reset payment obligations;

- Segment 2 –those where the borrower is unlikely to refinance into any readily available mortgage product and whose existing loan may be modified to extend the initial interest-rate reset period. Criteria to categorize these loans include an original or estimated current LTV of greater than 97%, credit score less than 660 and other criteria that would otherwise make the loan FHA ineligible.

- Segment 3 – those where the borrower is unlikely to refinance into any readily available mortgage product and the servicer is expected to pursue available loss mitigation actions.

As of March 31, 2008, approximately $22 million of mortgage loans that back our PCs and Structured Securities meet the qualifications of segment 2, Subprime ARM Loan. Our loss mitigation approach for Subprime ARM Loans under the ASF Framework is the same as any other delinquent loan underlying our PCs and Structured Securities. Refer to "Loss Mitigation Activities" in our 2007 Information Statement for a description of our approach to loss mitigation activity.

Alt-A Loans

Many mortgage market participants classify single-family loans with credit characteristics that range between their prime and subprime categories as Alt-A because these loans have a combination of characteristics of each category or may be underwritten with lower or alternative documentation than a full documentation mortgage loan. Although there is no universally accepted definition of Alt-A, industry participants have used this classification principally to describe loans for which the underwriting process has been streamlined in order to reduce the documentation requirements of the borrower or allow alternative documentation.

We principally acquire mortgage loans originated as Alt-A from our traditional lenders that largely specialize in originating prime mortgage loans. These lenders typically originate Alt-A loans as a complementary product offering and generally follow an origination path similar to that used for their prime origination process.

In determining our Alt-A exposure in loans underlying our single-family mortgage portfolio, we have classified mortgage loans as Alt-A if the lender that delivers them to us has classified the loans as Alt-A, or if the loans had reduced documentation requirements, which indicate that the loan should be classified as Alt-A. We estimate that approximately $188 billion, or 11%, of loans underlying our guaranteed PCs and Structured Securities at March 31, 2008 were classified as Alt-A mortgage loans. We estimate that approximately $2 billion, or 7%, of our investments in single-family mortgage loans in our retained portfolio were classified as Alt-A loans as of March 31, 2008. For all of these Alt-A loans combined, the average credit score was 723, the estimated current average LTV ratio was 76% and the delinquency rate, excluding certain Structured Transactions, was 2.32% at March 31, 2008.

We also invest in non-agency mortgage-related securities backed by Alt-A loans in our retained portfolio. ***We have classified these securities as Alt-A if the securities were labeled as Alt-A when sold to us or if we believe the underlying collateral includes a significant amount of Alt-A loans. We believe that approximately $50 billion and $51 billion of our single-family non-agency mortgage-related securities that are not backed by subprime loans are generally backed by Alt-A mortgage loans at March 31, 2008 and December 31, 2007, respectively***. We have focused our purchases on credit-enhanced, senior tranches of these securities, which provide additional protection due to subordination. We had unrealized losses, net of tax, on these securities totaling $7.1 billion and $1.7 billion as of March 31, 2008 and December 31, 2007, respectively. We estimate that the declines in fair values for most of these securities have been due to decreased liquidity and larger risk premiums in the mortgage market. We receive substantial monthly remittances of principal repayments on these securities, which totaled more than $2 billion during the first quarter of 2008. ***While it is possible that under certain conditions, defaults and severity of losses on these securities could exceed our subordination and credit enhancement levels and a principal loss could occur, we do not presently believe that those conditions are probable. As a result of our reviews, we have not identified any securities in our available-for-sale portfolio that are probable of incurring a contractual principal or interest loss. Based on our ability and intent to hold our available-for-sale securities for a sufficient time to recover all unrealized losses and our consideration of all available information, we have concluded that the reduction in fair value of these securities is temporary at this time***. However, if there is a subsequent deterioration of the individual performance of any of these securities, or if market conditions lead us to change our expectations relating to future performance, we could determine that impairment charges are warranted.

*   *   *

507. Later that morning, Defendants held an earnings conference call to discuss the Company's first quarter 2008 financial results. On the call, Defendants continued to tout the Company's strong capital position:

> **<u>Richard Syron – Freddie Mac Chairman, CEO</u>**
>
> Thanks Ed. Good morning, and thanks to all of you for taking the time. During the first quarter, we continued to see a housing market in distress. Throughout this period, Freddie Mac worked in a counter-cyclical way to support the housing finance market, and to advance the recovery of the housing sector. The company reported a net loss of $151 million for the first quarter, down significantly from our fourth quarter loss of about $2.5 billion.
>
> Our results reflected a balance of three factors. One, growing revenues based on increasing volumes. Two, changes in our accounting, that more closely aligns with the underlying performance of our business. And three, worsening credit conditions.
>
> ***In our single-family business we have improved our underwriting standards by insisting on better credit quality for new guarantees and reducing our volumes of riskier loan products***. By combining these efforts with the use of risk-based pricing, we assure continued credit access for America's homeowners.
>
> * * *
>
> Now previously, we have said that we expect housing prices to fall at least 15% nationally, peak to trough, and today they [have] fallen about 9% through the measure we use, which is relative to our market. We want to take a better look at the spring housing market to see whether or not the data is beginning to firm up. It is premature at this point from a data perspective, to make a change in our formal peak to trough estimate. However at this point, we must say that the risk to the forecasts are strongly weighted on the downside. ***Given the severity of the price declines in the first quarter, and the growing inventory of foreclosed homes, we have experienced an increase in charge-offs and REO expense associated with higher loan loss severities. As a result of this change, we raised our estimate for expected future default costs, and increased our provision***.
>
> ***Although credit will continue to be an overhang, significant advances in financial reporting, controls remediation, capital management and better returns on our growing new business volumes make me confident we can improve our bottom line results for 2008***. A healthy and profitable Freddie Mac is essential for the stability of the U.S. housing system, and for the benefit of the entire U.S. economy.
>
> During the first quarter, improvements in our financial reporting policies that better align realization of income and expenses, reduced our GAAP income statement sensitivity to changes in credit and interest rate markets. That helped our first quarter

results. These new accounting policies will make our future financial results more comparable to other financial institutions and more reflective of our underlying business.

During the first quarter we also made significant strides in completing our work on controls. Within our release in 44 days, we managed to slice 16 days off our schedule from year-end, and we've also completed the remediation of all of our material weaknesses. The combined effect of our simplified financial reporting, stronger controls and improved returns on our new business, put us in a position to manage our capital more effectively. ***With capital levels of more than $38 billion at the end of the first quarter - $6 billion above our mandatory target, and $11.5 billion above the statutory requirement, we do remain in a strong and sound capital position***.

* * *

<u>Buddy Piszel – Freddie Mac CFO</u>

Based on the strong revenue growth opportunities we're seeing, tied to the expanded role for the GSEs that Dick talked about, ***we decided to raise an additional amount of capital to fund future growth***. While we expect to formally launch the transaction, in the very near term, I am comfortable enough with our status to give you some high level elements of our plan. Our plan is raise $5.5 billion, split roughly 50/50 between a non-convertible preferred, structure and common**. *We do not currently anticipate further reductions in dividend payments***. As we indicated on our investor day, we are proceeding thoughtfully in our capital raise process, and will initiate the offerings, once our SEC registration is complete, which again, should be very shortly. So that means from a registration standpoint we are ahead from where we expected to be.

If you now turn to slide two, this slide gives you a high level overview of our current capital position and how we would expect to look once we complete our issuance. Raising this amount of capital will provide three benefits. First it will provide for flexibility and strength that will help fund profitable growth opportunities in our business.

Second OFHEO has told us that upon completion of our planned capital offerings, the intent is to reduce our mandatory target capital surplus amount to 15%, from the current level of 20%. In addition, OFHEO has informed us that it intends to further reduce the surplus amount to 10%, based on the following - completion of the SEC process, completion of the remaining consent order requirement to separate the position of Chairman and CEO, and our commitment to continue to hold capital well above the regulatory requirement, and lastly, no material adverse change to our ongoing regulatory compliance. Finally, the capital will provide us with additional downside protection in the event of dramatic credit deterioration.

Just as important to strong capital is the fact that given our reduced mark-to-market sensitivity, there is a greatly reduced risk, of fresh capital being used to fill a hole.

* * *

Finally, slide seven, shows that despite the continued high-level of charge-offs we remain very adequately reserved for our expected losses. As of the end of March, our ratio of reserves to expected charge-offs was 1.6 times, consistent with where we were at year end. Another way to think about reserve coverage is as a ratio to recent period losses. On this metric, our reserve to annualized first quarter charge-offs is about 1.6 times.

One final point before I turn things over to Patti. ***We did not take any impairments on our ABS portfolio in the quarter. As we've discussed in the past, we perform a very rigorous security-by-security analysis and given both our intent and our ability to hold securities until maturity, we have not identified any securities where losses are probable. We're watching all aspects of our ABS holdings very closely, in particular, a limited subset of our holdings, including a small percentage of our all day securities, and a few hundred million dollars of originally AAA-rated securities backed by second liens***. Likewise, a subset of our holdings are backed by monoline insurers which is factored into the recovery expectations for those securities. ***At this point we are not expecting to impair any material amounts of our ABS portfolio, over the next several quarters, this evaluation is done on a quarterly basis, and could change as market continues evolve, or if the realized or expected performance of individual securities significantly deteriorates***.

So to sum it up, from a financial perspective, the key take aways for the first quarter are - credit costs are up but manageable, interest and credit mark sensitivity have greatly improved, we are expecting significant revenue growth for the balance of the year, ***and the combination of our existing capital base, our capital raise, and the regulatory relief, puts us in a very strong capital position***.

* * *

<u>Patti Cook – Freddie Mac Chief Business Officer</u>

As you can see on the top of slide 10, about half of our first quarter realized losses came from those two book years, and we expect future losses to continue to be disproportionately related to 2006 and 2007 originations. Detailed analysis of the 2006 book has allowed us to attribute this poor credit performance to certain risk variables, for example, low FICO scores, high TLTVs and low documentation loans, as I mentioned earlier. This formed the foundation for the risk based delivery fees we have introduced over the last several months, and which will be fully effective by the end of the second quarter.

In addition to these increases, we also tightened some credit terms. On slide 11 you can see how these changes have dramatically reduced the proportion of our deliveries

with low FICO scores, high TLTV, loan documentation, and loans that have second lien exposure, since the peak in September or October of last year. As a result of these changes, the expected lifetime default cost, on the worst quintile of new guarantees, has fallen by more than 40% from its peak. We believe these changes to our terms of business, will allow us to provide the liquidity the mortgage markets need in a responsible risk-disciplined way that is endurable.

So while credit losses will continue to be a drag on earnings for several quarters, the underlying fundamentals of our business have greatly improved. Beginning in early 2007, as other mortgage investors were trenched, our penetration of the conventional conforming market increased. The GSE share rose from 39% in the first quarter in 2006, to more than 80% at March 31, as shown on slide 12. Initially this increase in share wasn't at attractive terms. The credit quality was worse, and we weren't getting paid for the additional risk. However, with the tightening of terms, and the increases in fees that we have begun to implement, the expected returns on our current flow, are substantially better. We would expect g-fees on fourth quarter volumes to be around 25 to 30 basis point, depending on the mix of business. This is down slightly from the level we discussed on our investor day, primarily based on our expectation of the credit quality of new deliveries for the remainder of the year. While all-in reported g-fees on our total portfolio climbed to more than 20 basis points in the first quarter, up from 18 in the fourth, the majority of this increase reflects product mix and stepped up amortization of deferred fees. So as our old book runs off, and 2008 deliveries come on at higher fees, we should naturally see our all in g-fees migrate higher.

Coupled with our expectation for guarantee portfolio growth for 2008, this should produce revenue growth of 15% to 20% for the year. While much smaller in dollar volume, the multifamily business has enjoyed a similar resurgence. Higher volumes, better pricing, and better terms. This adjustment allows us to provide the liquidity needed in this market.

Let's return now to the retained portfolio, slide 13. This is one area where our strategy has changed meaningfully since the investor day. While our purchase activity picked up significantly in late February in response to the widest spreads we had seen in decades, ***the improved outlook on the capital front resulting from the reduction in the capital surplus, the planned capital raise, and the improved GAAP income picture, allowed us to maintain this more active posture, and begin to grow our retained portfolio***. The left-hand panel in slide 13, shows the surge in commitments that has occurred in March, and then again in April. Most of these will settle in the next couple months, producing sharp growth in our settled portfolio balance. As with the guarantee business, these volumes have come at increasing levels of profitability and provide a material support to mortgage market liquidity.

The graph on the right shows the LIBOR OAS levels for plain vanilla agency fixed-rate and floating-rate securities between July of 2007 and today. An important point to note is that while the graph shows directionally where spreads have gone, we have done better both because our debt funds below LIBOR, and because we can

concentrate our purchases in the specific products that provide the best risk-adjusted returns.

From early March through mid-May, Freddie Mac entered into approximately $100 billion in new purchase commitments, including both fixed- and floating-rate agency mortgage securities. The purchases executed during March and April were done at average levels of about 90 basis points of agency OAS, and initial GAAP NIM of about 150 basis points. Since GAAP NIM does not reflect our long-term funding cost, or the cost of hedging interest risk, it is higher than the OAS. Based on the increased availability of capital, and attractive opportunities, we expect to grow the portfolio significantly in 2008. And that has continued to support the liquidity and stability of the mortgage market. Putting volume and price together, we estimate that the effect of new portfolio adds, should be in the range of 40% to 50% revenue increase, from net interest income in 2008 versus 2007.

So to sum up, while house price declines have led to continued credit losses, the improvement in our underwriting standards, increased pricing and guarantee fees, growing retained portfolio purchases, and significantly higher ROEs on new business, give us confidence in the future return prospects for Freddie Mac. The additional release of regulatory capital surplus announced today by a regulator, and the issuance of $5.5 billion in securities, will provide for flexibility and growth in our business.

* * *

Richard Syron – Freddie Mac Chairman, CEO

Turning back to the business, we have tried to set forth a clearer picture for you. It's plain we've reduced our losses in the fourth quarter considerably. ***And with the benefit of our improved financial reporting, all you have to do is look under the hood to see that our 2008 book of business, and going forward, is on track to be much higher in quality, larger in volumes, increasing in guarantee returns, and wider in investment spreads. Simply put, we are confident that the capital we are raising will enable us to both advance our mission and increase our returns to shareholders. So, yes, our credit losses are increasing in this environment, but they are concentrated, and we believe under any reasonable scenario, manageable and mitigated by attractive revenue growth going forward***.

* * *

508. During the question and answer section, it was clear analysts were accepting Defendants' distorted version of Freddie Mac's true financial condition and future business prospects and believed the Company was moving in a positive direction. Indeed, Howard Shaprio,

an analyst with Fox-Pitt Kelton stated, "***First of all congratulations on an excellent quarter. It definitely seems like you turned the corner***."

509. Later, Piszel continued to mislead the market as to the strength of the Company's non-prime holdings:

> **<u>Brad Ball – Citigroup Analyst</u>**
>
> Yes, actually a follow up on the ABS portfolio Slide 21, I wonder if you could just spend a few minutes describing what is in there, and if there are any major changes versus the presentation in the fourth quarter? And what gives you confidence that there are not any permanent impairments in the subprime ABS?
>
> **<u>Buddy Piszel – Freddie Mac CFO</u>**
>
> ***Brad as I said, our view of the subprime portfolio has not changed. So this does not reflect a deterioration, or a change in our expectations. What I liked about this slide, is it just reflects how well protected the subprime portfolio is***. And if you look on the most right-hand side, there is a percentage of the securities that you cannot model a loss on. And then as you go across the page you can see the level of defaults that you have to incur in order to the penetrate the protection that is there.
>
> ***So we continue to do a very, very rigorous evaluation, security by security. Our expectations are that we are not going to have impairments in this portfolio without dramatic degradation of credit from where it is today***. And we still feel pretty good. So no changes at all in the way we think about things. We just thought this slide was helpful to sort of put this in perspective.

* * *

510. Piszel also made false and misleading statements concerning the Company's loan loss provisioning and capital position:

> **<u>Bruce Harting – Lehman Brothers Analyst</u>**
>
> Buddy, I just wanted clarify, have you said in the past that your target is to make this year's provisioning your peak year? And I could be wrong on that comment. But if you did say that, is that still the case? And if you didn't, any comment on that.
>
> **<u>Buddy Piszel – Freddie Mac CFO</u>**
>
> ***I think we did say that. When we looked at this originally, Bruce, I think we had '08 being the peak, and '09 being a little less, but not a lot, with our increase in '08, it's is still by our own reckoning, would be the peak, but '09 goes up too. The hill got a little - it plateaued a little bit longer, and then 2010 is dramatically lower.***

So it is really like two years of pretty heavy provisioning. But again, given the expected revenue growth, we are in a very good position to be able to manage through that.

*　　*　　*

Bruce Harting – Lehman Brothers Analyst

Okay, and then my last question is in terms of the excess capital decreases that are pending, and the amount of capital that you're raising, you're at about $14 billion, $15 billion of excess capital, by say September. And you know it seems like the pro-cyclical nature at the bottom, or at the worst part of the cycle raising capital, and building reserves, the question would be sort of based on the strong growth that you're targeting, you still, by my calculation it only uses about maybe $3 billion to $4 billion of capital over the next 12 months. So you're still going to be in a very significant over capitalization situation say, by mid-to late '09, as credit costs hopefully peak, and start to come down. And it seems like there's other redundancies in terms of reserves. I know it's early days to start thinking about how to deploy those redundancies, but you know by 2010, what would likely give in terms of some of these reserve redundancies and excess capital, or would you really just grow your way into the excess capital, or are you thinking that some of the preferred, might have a non-call two or three feature, that sort of thing? Thanks.

Buddy Piszel – Freddie Mac CFO

Let me start, and then others can chime in. ***We are deliberately putting ourselves in a very, very strong capital position***. I think your observation is right, that ***even with the kind of growth that we're anticipating, we'll end the year in a very strong capital position***. We are doing this capital raise, to make sure that even if credit goes, way worse than we're currently expected, we have got the capital position to be able to sustain that.

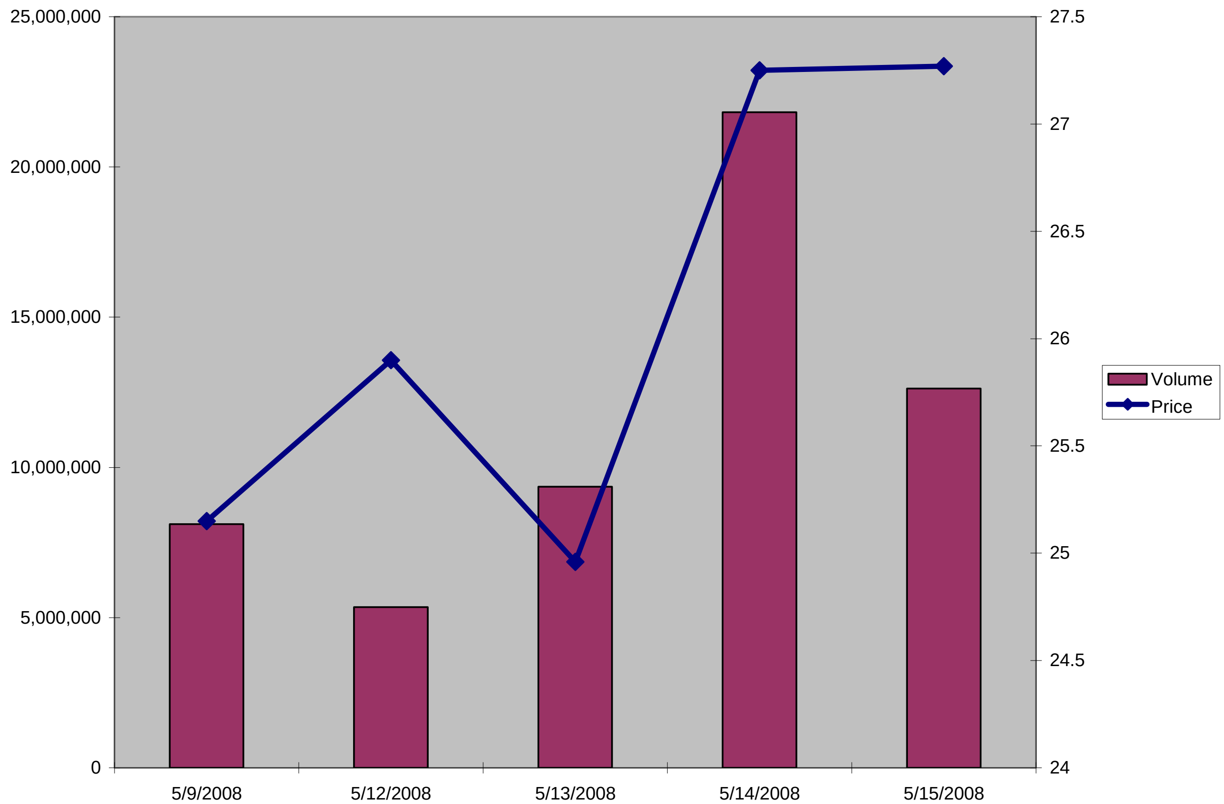
You're right also, that once you get if, in fact, things go the way we're planning, if at some point you can get back to a more rational capital structure. If we can grow our way -whether we can grow our way to absorb that, depends on where the spread opportunities are. And if they're not there, then over time we're going to have to get our capital structure back in line. And that's the way we would look at it, ***but I think at this point we're better off being in a very, very strong position, than hoping for the best. So that's the way we're thinking about it***.

*　　*　　*

511. On that same day, Foxx-Pitt issued an analyst report stating that ***"[w]e believe FRE has turned the corner and is now a revenue growth story."*** Foxx-Pitt also upgraded Freddie Mac

stock to outperform from in-line and reiterated the view, as articulated by Defendants, that they did not expect Freddie Mac to take an other-than-temporary impairment charge.

512. In response to the false and misleading statements contained in the May 14, 2008 Financial Report, related press release and conference call, the trading price of Freddie Mac common stock increased significantly and was further artificially inflated, as it rose sharply from a closing price of $24.96 on May 13, 2008 to as high as $27.56 on May 14, 2008, before closing at $27.25, an increase of more than 9% on a significant increase in trading volume, as demonstrated in the chart below:



513. During that same period of time, Freddie Mac's preferred shares increased as much as 8%.

514. The statements referenced in ¶¶504-07 and 509-10 were each materially false and misleading when made for the reasons set forth in ¶452 and the factual detail contained throughout

this Complaint. In addition, the statements referenced in ¶¶504-07 and 509-10 were materially false and misleading when made because they represented and/or omitted adverse facts which then existed and disclosure of which was necessary to make the statements not false and/or misleading. The true facts, which were known to or recklessly disregarded by each of the Defendants, were:

- Notwithstanding their Class Period statements that the Company was deploying its capital to make "the most of the excellent opportunities" in the market, the Company was drowning in a sea of subprime and non-traditional assets, which rendered these "opportunities" meaningless and illusory.

- Despite trumpeting market share growth and professions that they had put Freddie Mac on a "better foundation," Defendants continued to refuse to disclose that Freddie Mac's foundation was resting heavily on extremely risky subprime and other non-prime and non-traditional loans, which constituted almost 50% of the Company's 2007 purchases. Thus, the Company's foundation was anything but solid. Virtually all of the single family private MBS the Company purchased were not backed by investment grade loans – they were backed by Alt-A, subprime, and other default prone, non-prime and non-traditional loans. Indeed, during 2006 and 2007, ***100%*** of such purchases consisted of these non-prime and non-traditional loans. Also, during 2006 through 2007, Freddie Mac accounted for ***70%*** – or $120 billion – of the GSEs' subprime MBS purchases.

- Defendants knew that Freddie Mac's 2007 book of business was the worst book of business it ever had in terms of objective credit risk characteristics. While Defendants described Freddie Mac as having a strong foundation for the future, this foundation, as Defendants knew, was fatally flawed, as it was built on $628.5 billion in subprime, Alt-A and other default prone loans and subprime and Alt-A MBS, amounting to 32% of the Company's credit risk exposure.

- By May 2008, the key risk indicators and critical thresholds identified and included in the August 2007 risk report had long-since materialized. Although Defendants painted a picture of the Company managing its risks, the undisclosed truth was that Defendants had done nothing to address or remedy the material weaknesses destroying the Company's viability. As Defendants knew well, their statements regarding the adequacy of Freddie Mac's capital were not substantiated and were nothing more than complete fabrications that ignored reality.

- Defendants' statements concerning the "temporary" impairment to the fair value of its securities remained dependent on violations of GAAP, and once again overstated the Company's net income and regulatory capital surplus during the Class Period. Indeed, in the prior 90 days, the value of the Company's ABS subprime and Alt-A investments had plunged by more than $17 billion, causing the unrealized loss on Freddie Mac's AFS securities to grow to a level that exceeded the Company's directed minimum capital standard by almost 10 times. Therefore, Defendants

lacked a reasonable basis for stating the Company did not have impairments in its ABS portfolio, and such statements were misleading to the market.

- Defendants were staring down a sea of red flags that it was not at all probable that Freddie Mac could collect all amounts due on its ABS subprime and Alt-A investments in accordance with their contractual terms. Certain of Freddie Mac's AFS subprime and Alt-A investments had been in a loss position for at least a year and the amount of the losses on such securities was in excess of $10.5 billion. The value of these investments was impaired, rendering the Company's financial reporting false and misleading when made.

- The Company was not in a "very strong capital position." To the contrary, had the Company established the necessary valuation allowed to account for the amount of its deferred tax benefit, it would have been in violation of its directed minimum capital standard of $6 billion by $13 billion.

- The financial strength of the primary mortgage insurers Freddie Mac utilized to credit enhance and mitigate the risk of mortgage loans had been severely diminished. Despite this fact, Defendants highlighted the importance and effectiveness of these (illusory) credit enhancements to deceptively support their highly unreasonable failure to record an other-than-temporary impairment in the value of Freddie Mac's investments in subprime and non-prime securities, and to continue to falsely tout the strength of the Company's capital position.

515. On May 20, 2008, Defendant Piszel spoke at the Eleventh Annual Lehman Brothers Financial Services Conference, where he stated in part:

> **<u>Buddy Piszel – Freddie Mac EVP and CFO</u>**
>
> Today, given the pullback from the mortgage market by Wall Street, Freddie and Fannie are financing more than 80% of U.S. mortgages, and that's up from 40% just a couple years ago, and it creates a completely different competitive dynamic for us, and I'll talk a little bit about this.
>
> On this slide, on the left-hand side, you can see we guarantee credit risk on residential mortgages in our single-family business, and as of March, we had guaranteed about $1.8 trillion. That also helps us promote affordability of home ownership, but we also had experienced credit losses that are far lower than the industry as a whole.
>
> Second, on the right-hand side, we invest in mortgage and mortgage-related securities through our retained portfolio. We have a longstanding track record of very strong interest rate risk management. *At the end of April, the portfolio stood at $738 billion, and it's invested in loans and various high-quality securities.* We do not take bets on interest rates. We fund to maturity, and we're a buy-and-hold

investor, and we make our money through managing and having a long-term core spread come through our earnings.

*   *   *

So here are the main takeaways from today's discussion.

First, it should come as no surprise that in the first quarter of 2008, our results were negatively impacted by worsening credit conditions. Overall, we lost $151 million for the quarter. We don't like losing money, but that's certainly a far greater improvement than the fourth quarter of 2007, where we lost $2.5 [billion].

Clearly, our results were helped in the first quarter by simplification in our financial reporting, but quite frankly, that just more closely aligns the emergence of our profits and our reporting with the underlying economics of the business.

Third, we showed strong momentum in market share, business volumes, margins, and total revenue.

Fourth, our credit exposure is really concentrated into 2006 and 2007 vintages, and we're seeing significant improvements in the 2008 [purposes] already, and we expect that to continue.

And, lastly, we have a very solid capital base. At the end of the quarter, we were $5.5 billion -- actually, we were $6 billion higher than our regulatory minimum, and we announced a commitment to raise about $5.5 billion in new capital, and that will enable us to be able to fund growth and also give us downside protection.

Let me start out about capital because that's been the whole discussion and the focus for at least the last couple quarters.

At the end of the quarter, we had $38 billion in regulatory capital. ***That was $11.5 billion over our statutory requirement, and we believe our capital position is very strong and very sound***.

*   *   *

We've had a lot of questions today about, well, what if it's 20%? What if it's 25%? And you can see there are only a couple ways to get to those kinds of numbers. Either the really bad states where all the overbuilding was have to become severe declines. So you have to have California down 50% to make your own decision around how reasonable that is. We would say at this point that doesn't appear reasonable.

Or, you'd have to have the economy go into the tank in a much more blended view of the way house prices are going down nationally. And, again, it's very uneven now, and we don't see the factors that would drive it overall to be even.

Now, one of the things about our Company is that we have very, very tight underwriting, and relative to the overall market, our experience in the credit book is much, much better. So when you look at the average market participant in the mortgage space, you can see that as of the end of the year, they were at 167 points of serious delinquencies. We were at 65. And while we've gone up to 77 basis points of the overall portfolio in the first quarter, we would expect that the green bar has also extended.

So that goes to the point that we do not participate in the jumbo space. ***We do not participate at the lower end of the credit quality anywhere near the size of the overall market***. And to give you another factor, California, which is 24% of the UPB of the U.S. mortgage market, they only have a 13% representational share.

We've said that our credit profile is improving, and this is very important. For us to make an argument that the credit experience is going to be manageable, '08 has to get better. The credit experience in the '08 book has to get better than it was in '06 and '07, and based on all the analysis that we've done, we think the bulk of our credit exposure is going to lie with the '06 and the '07 books. Both [inaudible]'s already benefited from a lot of house price appreciation, so that's pretty well insulated at this point. The '06 and the '07 books were a lesser credit quality, although [inaudible], and they immediately got hit with the downturn in house prices. The '08 book, as you can see here, if you look at the lowest quintile of the delivery, you see a very dramatic improvement in the expense of default costs for the worst part of the book, and that's a month-by-month improvement since October or so of 2007, and it's continuing. So that is a -- that bodes well as far as we're thinking about the way credit is going to progress.

Another thing you've got to think about is that for each quarter of '08, if, in fact, we're right about the way house prices are going to eventually run out of steam on the drop, the originations in each quarter are closer and closer to better default outcomes because as soon as you get the house price down[draft], it affected the full expectation for the portfolio. So first quarter deliveries will have higher default costs, and, second, assuming it stays -- is the same mix, which would be less than the third, which would be less than the fourth quarter, and that's the way to think about sort of the blended outcome for 2008, which we're very happy it's improving due to our actions on underwriting and the overall market.

This goes to the point I made earlier about share. At this point, between Freddie and Fannie, we're in excess of 80% of the overall marketplace, and quite frankly, we don't see that going away any time soon. Wall Street has retreated to private label, the market has essentially dried up, and we're nearly the only game in town, and we think that we're going to be enjoying that position for a number of years.

* * *

516. Piszel next misled the market concerning the credit quality of the Company's ABS portfolio, stating in part:

> Turning to the credit quality of the portfolio, a couple points to make here.
>
> One, we had zero CDO exposure. ***We do have about $90 billion in ABS sub-prime and then some exposure to Alt-A***.
>
> ***And, secondly, about the ABS, we've provided an awful lot of information out there to make the point that despite where market prices are right now, we believe this portfolio is [money good], and we are not expecting any significant impairments or charters in the P&L for the next couple quarters***.
>
> ***Certainly, we have an analysis that shows what the cumulative defaults have been, the cumulative delinquencies have been on these portfolios. If they deteriorate way worse than we are expecting, it could trigger an impairment, but it will be on a relatively small subset of the portfolio. The places where we got the most exposure is in roughly $500 million of Alt-A and second lien holdings, and even there, you've got a ways to go before you can pierce them due to the level of collateral that's there***.
>
> I love this slide because it makes the point about what is the exposure within the sub-prime portfolio, and what this slide is showing is by vintage year what the cumulative default cost would have to be in order to pierce through the credit protection and still think it's [deteriorating]. ***And on the most right-hand side, you can see there it says, "No loss." That's essential -- the way these securities were constructed, you cannot model them to get a loss. If everything defaults like crazy because all the cash flows go to the front triple-A traunches, the bonds pay off***.
>
> And then as you go across the page, you can see that's UPB. That would be exposed to a loss. The actual dollars lost in this structure, it's like $10 million in real losses if you got to 50 to 55% defaults and then 50 to 60% of them.
>
> ***So this is a very, very well insulated portfolio***. It's paying down very quickly. Two years from March 31, the 90 billion will be close to 30 billion. ***So it pays down quickly, and we would argue that it is very, very well insulated against loss***.
>
> * * *
>
> I think that we really exasperated our own position by first being arrogant and then falling down the way we fell down so that you could be exploited when you were in a weakened condition***. We put the Company in a weakened condition for a number of years. That will never happen***. We're going to try to regain our reputation by doing the good things that we're doing in the market right now.
>
> We're active in every aspect of this market trying to make a difference and trying to help people. And even the critics at some point will have to acknowledge that that is

good work on behalf of the overall U.S. housing markets. And so we always have -- the [inaudible] I get my weekly -- or every single Monday I walk in to the weekend -- summary of the weekend press. Do I think it's fair? No. Do I think it's accurate? Largely not. [Inaudible] stick around for a while? Yeah, probably for a while. ***Should it subside as we demonstrate first that our capital strength is fine, our earnings are going to recover, and we're doing good things?*** I would hope so, but we'll have to wait and see.

* * *

517. In response to Defendants' false and misleading statements on May 20, 2008, the trading price of Freddie Mac common stock dropped approximately 2.6% from $27.01 on May 19, 2008 to a close of $26.31 on May 20, 2008, and its preferred stock dropped as much as 5% per share. If not for Defendants' materially false and misleading statements, market expectations would have been at least partially corrected and the Company's stock price would have fallen further on May 20, 2008.

518. The statements referenced in ¶¶515-16 were each materially false and misleading when made for the reasons set forth in ¶452 and the factual detail contained throughout this Complaint. In addition, the statements referenced in ¶¶515-16 were materially false and misleading when made because they represented and/or omitted adverse facts which then existed and disclosure of which was necessary to make the statements not false and/or misleading. The true facts, which were known to or recklessly disregarded by each of the Defendants, were:

- Though Defendants stated that the Company did not participate in the lower end of the credit spectrum anywhere near the size of the overall market, in fact, 35% of Freddie Mac's entire book of business was comprised of subprime, Alt-A and other default-prone loans and subprime and Alt-A MBS investments – a percentage comparable to that of the overall market.

- Defendants underwriting standards had deteriorated over the prior five years to the point where the Company stopped using its own underwriting guidelines in many instances and began using those of so-called "inferior" mortgage lenders. As a result of Defendants' incentivized "pay for performance" compensation structure (which earned the Individual Defendants a staggering $80 million in total compensation between 2003 and 2008), Defendants focused on quantity rather than credit quality, ultimately leading to 50% or more of the Company's single family purchases

consisted of subprime, Alt-A, or other non-prime loans or securities in each of 2005, 2006, and 2007.

- Defendants knew that the Company's exposure to losses from these non-prime, non-traditional loans had put Freddie Mac in such a precarious financial position that Defendants chose to manipulate Freddie Mac's financial results and accounting practices in a manner designed to avoid taking losses that should have been taken in earlier reporting periods.

519. On June 6, 2008, Freddie Mac held its 2008 Annual Stockholder's Meeting. At the meeting, Defendant Syron continued to mislead investors about the Company's business, stating:

> ***I want to talk a little bit, just while the votes are being counted, about the plusses and minuses of this and specifically in detail why, going forward, that we're quite confident that the positive changes, the positive delta, if you will, outweigh the negative deltas as we go forward***. We also want to leave time for your questions.
>
> *   *   *
>
> ***We have significantly improved our accounting thanks in large part to our Chief Financial Officer, Buddy Piszel, and his team. Because of these enhancements our accounting today is more transparent, more comparable to our peers and provides more consistency in our treatment of capital***. We have raised prices and tightened credit terms, both significantly and both appropriately if you look at what's happened in the market recently. These steps were essential and they came, I can assure you, after only the most careful and detailed consideration.
>
> At the same time, consistent with our obligations as the unique kind of institution we are, we've continued to subsidize our affordable business. ***We think we've acted prudently and decisively to protect and bolster our capital. Late in the year, you know we successfully raised about $6 billion; not about $6 billion, $6 billion; in preferred capital***.
>
> *   *   *
>
> ***Given the excellent business opportunities we're seeing, we think that we have a moment in which there is enormous confluence between the interests of our shareholders and at the same time, doing what we're supposed to do under our mission: providing stability, liquidity, and affordability in the mortgage market***.
>
> *   *   *
>
> These are just some of the key things we've done and the changes we've made to respond to a really historical housing situation, one that we certainly haven't seen since the Great Depression. ***The results, so far in this year, in '08, was a GAAP loss of $151 million, not a profit, but still clearly, I think, a turn in the right direction***.

We believe our 2008 results will be significantly better than 2007 and that the current tale of two Freddies that I described, the best of times in terms of revenue growth and profitability, are yet to come. That doesn't mean we're ignoring the negatives and we can't. Credit continues to weaken, just look at the papers every day. Our provision is growing. We are keeping a very, very close eye on falling housing prices almost on a daily basis, but we believe all of this will be manageable, not desirable, but manageable for three reasons:

First, we have already reflected on our results more than $7 billion of future losses for the combined effect of our reserved and credit related mark to market items.

Second, our overall asset quality continues to be among the best in the industry with a mortgage portfolio, which, compared to our competitors' is low in loan-to-value ratios, low in holdings of exotic mortgages, and high in regional diversification and high in credit quality.

Third, the revenue engine of our business is showing more horsepower than it has in many, many years thanks to the volumes that we've seen improve, the appropriate changes in credit terms and in prices and the investment opportunities spreads that we're seeing. Specifically, as we indicated in our first quarter conference call, for the full year of 2008 based on current growth opportunities and credit conditions we'd expect to achieve a 15% to 20% growth from our guarantee business, very strong growth in net interest income. On the credit side we also expect to see an increase in our 2008 provision of another $5 to $6 billion.

The bottom line is that while our credit costs are increasing in this tough environment, we believe they're manageable in any realistic scenario and mitigated by our revenue growth going forward. Essentially, you have two buckets. You can think of the Freddie going forward. We have these great opportunities, better pricing, better spreads lifting us up in the drag down from some of the previous-year books.

* * *

I know you're not satisfied with Freddie Mac, your investment in the company. I think I can say fairly neither am I and I can certainly tell you our directors are not. ***Your senior management team will not be satisfied until you've received a fair return on the capital you've invested in the company***. This is something we stressed both internally and vociferously externally as legislation moves forward on the GSEs. Meanwhile, we want to thank you for your continued support in very difficult days for the enterprise, but we think we will build shareholder value by meeting our statutory measure. ***As Freddie Mac's turnaround gains momentum, we're very committed to ensuring that you, our owners, will be duly rewarded***. After all, you're the ones that provide the private capital that we've been stressing in discussions that provide the GSEs to serve this public mission at all in the first place. Again, thank you for being here and listening.

*   *   *

520. In response to Defendants' false and misleading statements during the June 6, 2008 Annual Stockholders Meeting, the trading price of Freddie Mac common stock dropped approximately 8% from $25.29 on June 5, 2008 to a close of $23.96 on June 6, 2008, with the preferred stock closing down as much as 12% per share. If not for Defendants' materially false and misleading statements, market expectations would have been at least partially corrected and the Company's stock price would have fallen further on May 20, 2008.

521. The statements referenced in ¶¶519 were each materially false and misleading when made for the reasons set forth in ¶452 and the factual detail contained throughout this Complaint. In addition, the statements referenced in ¶519 were materially false and misleading when made because they represented and/or omitted adverse facts which then existed and disclosure of which was necessary to make the statements not false and/or misleading. The true facts, which were known to or recklessly disregarded by each of the Defendants, were:

- Defendants knew that, notwithstanding their Class Period statements that they were seeing "excellent business opportunities," the presence in the Company's portfolio of hundreds of billions of dollars of toxic, non-prime and non-traditional loans that were not disclosed by Defendants to the market during the Class Period rendered these "excellent business opportunities" meaningless and illusory.

- While Defendants stated that 2008 results would be significantly better than 2007, Defendants knew this to be false as the Company was sitting on a "bomb that was ready to go off" in the form of $628.5 billion in subprime, Alt-A and other default prone loans and subprime and Alt-A MBS that were increasingly becoming delinquent and defaulting at higher and higher rates and had already essentially bankrupted the Company.

- Defendants failed to disclose to the market the Company's feeble capital position, while manipulating Freddie Mac's financial results and accounting practices in a manner designed to avoid taking losses that should have been taken in earlier reporting periods. Defendants' actions had the effect of making the Company appear more profitable than it was and distorting the truth regarding its financial health and future business prospects.

- Defendants were well aware that the $6 billion capital infusion was merely a temporary respite because Freddie Mac was saddled with massive, unavoidable, other-than-temporary impairments on its subprime, other non-prime, and non-traditional mortgage related assets.

522. On June 18, 2008, Foxx-Pitt published a report based upon a series of meetings that the company's analysts had with Freddie Mac's senior management, including Syron and Piszel. Fox-Pitt noted that key takeaways from the meeting included:

> After current contemplated capital raise, even in a worst case scenario (which we define below), company's capital position should be more than adequate with sufficient capital to fund growth; 2) the company should report positive (operating) earnings even under worst case scenario in '09 and '10, and earnings after '10 should be "turbocharged" by strong business prospects in this environment…

B. Defendants' Fabricated Story Begins To Fall Apart

523. Beginning on July 3, 2008, a flurry of news began to partially reveal the true financial picture at Freddie Mac, even while Defendants continued making false and misleading statements concerning the true financial condition and future business prospects of the Company. As set forth in further detail below, as this series of partial disclosures of the truth regarding Freddie Mac's financials and true business prospects gradually were revealed to the market, the artificial inflation in the Company's stock, which was caused by Defendants' fraud, leaked out. It was not until the end of the Class Period, however, when the truth was finally revealed, that all of the artificial inflation was dissipated. Prior to that, Defendants' false and misleading statements either increased the artificial inflation in Freddie Mac's stock or prevented it from leaking out as quickly as it would have had the truth been revealed *in toto* instead of in dribs and drabs.

(a) On July 3, 2008, the *Wall Street Journal* ran an article titled "A Delay-of-Pain Penalty" indicating investors were concerned Freddie Mac was having trouble raising the $5.5 billion in new capital it outlined back in May 2008. The article described how the delay in raising the new capital was a result of Freddie Mac's delays in fixing its financial reporting controls. ***In***

response to this partial revelation Freddie Mac's true financial condition and future business prospects, the trading price of Freddie Mac common stock declined 8.9%, from $15.92 on July 2, 2008 to $14.50 on July 3, 2008, and the preferred stock declined as much as 6% per share;

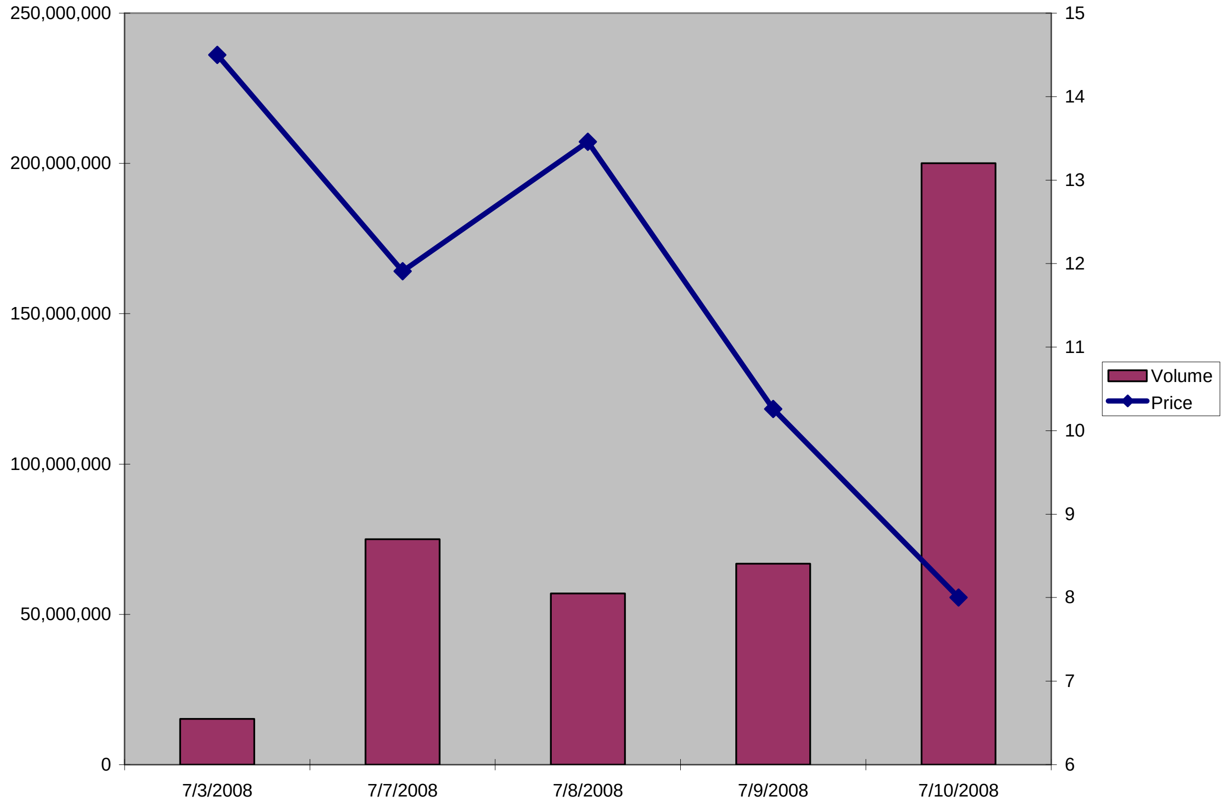
(b) On July 7, 2008, Lehman Brothers issued an analyst report indicating Freddie Mac and Fannie Mae may need to raise billions of dollars if certain accounting rules changed. According to the analyst report, the Financial Accounting Standards Board (FASB) was considering a rule change that would force Freddie to move so-called off balance sheet securities onto the Company's balance sheets. If that change happened, it would require Freddie Mac to add $29 billion of capital. Among other things, the Lehman Brothers report refocused investors on the potential capital inadequacy of Freddie Mac. ***In response to this additional partial revelation of Freddie Mac's true financial condition and future business prospects, the trading price of Freddie Mac common stock declined 17.9%, from $14.50 on July 3, 2008 to $11.91 on July 7, 2008 (the next trading day), and the preferred stock fell as much as 28% per share***;

(c) On July 9, 2008, *Reuters* and *Dow Jones* both ran articles indicating there was renewed worry that Freddie Mac would need to raise massive amounts of new capital through stock sales that would devalue existing shareholders' stakes. The *Reuters* article noted Freddie Mac's window of opportunity to raise the $5.5 billion in new capital the Company announced it would raise "has likely closed." The *Reuters* article quoted Weston Boone, a vice president of listed trading at Stifel Nicolaus Capital Markets, as stating "[Freddie Mac and Fannie Mae are] going to have to raise capital going forward. It's going to be diluted transaction [and] there's nothing we can do about it. . . ." ***In response to this additional partial revelation of Freddie Mac's true financial condition and future business prospects, the trading price of Freddie Mac common stock declined 23.8%,***

from $13.46 on July 8, 2008 to $10.26 on July 9, 2008, while the preferred stock declined by as much as 8% per share;

(d) On July 10, 2008, *Bloomberg* ran an article quoting former St. Louis Federal Reserve President William Poole saying Freddie Mac was "insolvent" and may need a U.S. government bailout. According to Poole, "[c]hances are increasing that the government may need to bail out the two mortgage companies." ***In response to this additional partial revelation of Freddie Mac's true financial condition and future business prospects, the trading price of Freddie Mac common stock declined 22.0%, from $10.26 on July 9, 2008 to $8.00 on July 10, 2008, while the preferred stock declined by as much as 21% per share.***.

524. The partial revelations of the Company's true financial condition, which partly corrected the market's expectations for the Company's financial performance and outlook, had a devastating impact on the trading price of Freddie Mac common stock and preferred stock, as set forth specifically above. The chart below reveals the true extent of the damage caused to the trading price of Freddie Mac common stock during the July 3, 2008 through July 10, 2008 period, as well as the tremendous increase in trading volume:



525. In response to all of these partial revelations of Freddie Mac's true financial circumstances and future business prospects, Defendants went on the offensive yet again in a last ditch attempt to perpetuate their lies and negate the impact of the partial revelations of the true financial condition and future business prospects at Freddie Mac. As such, on the afternoon of July 10, 2008, Freddie Mac spokeswoman Sharon McHale told *Reuters* that Freddie Mac ***"absolutely"*** had enough capital and that ***"we have maintained the highest possible capital rating and we continue to hold a surplus above our regulatory requirement, and that will enable us to continue to support the nation's housing markets as we've been doing."***

526. On July 11, 2008, Freddie Mac released a statement touting the Company's strong capital position. The press release stated, in pertinent part:

> ***Freddie Mac is adequately capitalized, highly liquid and an essential part of the nation's housing system. We are in the process of finalizing our results and we estimate that at June 30, 2008, we will have a substantial capital cushion above the***

> ***20% mandatory target surplus established by our regulator, the Office of Federal Housing Enterprise Oversight ("OFHEO") and a much greater surplus above the statutory minimum capital requirement***. We are not under any mandate to raise capital in the near term. OFHEO has stated that we are adequately capitalized and that we hold capital well in excess of regulatory minimums. The Director of OFHEO confirmed yesterday that we are adequately capitalized and have liquidity resources to perform our important public mission, and we are continuing to do so.
>
> Beyond that, there are a number of options to manage our capital position. The average rate of run-off on our retained portfolio is currently about $10 billion per month, and not replacing that run-off would free up approximately $250 million of capital per month. Over the course of a year, this would free up approximately $2.5 to $3 billion of additional capital if this run-off rate remains constant. We also could consider reducing our common stock dividend. Our current annual common stock dividend is approximately $650 million.
>
> ***Currently, Freddie Mac's liquidity position remains strong. This is a result of the combination of two factors: access to the debt markets at attractive spreads and an unencumbered agency MBS portfolio of approximately $550 billion which could serve as collateral for short-term borrowings***.
>
> ***We believe current speculation in the media around the issue of conservatorship does not accurately reflect the facts. Freddie Mac is not on the threshold of conservatorship because we are adequately capitalized. The preliminary indications of our expected financial performance for the second quarter, while reflecting the challenges that face the industry, do not point to an immediate need to raise additional capital***. As the Director of OFHEO stated, we remain committed to our agreement with OFHEO to raise additional capital given appropriate conditions.

* * *

527. In response to Defendants' additional false and misleading statements, on July 11, 2008, *TheStreet.com* ran an article titled "Fannie, Freddie Media Panic Overblown." Put simply, Defendants' false and misleading statements regarding the Company's capital adequacy had their intended effect: market participants were now faced with direct statements from the Company that it was "absolutely" well-capitalized, and the bleeding of the price of the Freddie Mac common stock essentially stopped, falling a mere $0.25 cents from $8.00 on July 10, 2008 to $7.75 on July 11, 2008, on astronomical trading volume of nearly 400,000,000 shares. Had Defendants not continued

to pepper the market with false and misleading statements, the trading price of Freddie Mac common stock would have dropped substantially more.

528. The statements referenced in ¶¶525-26 were each materially false and misleading when made for the reasons set forth in ¶452 and the factual detail contained throughout this Complaint. In addition, the statements referenced in ¶¶525-26 were materially false and misleading when made because they represented and/or omitted adverse facts which then existed and disclosure of which was necessary to make the statements not false and/or misleading. The true facts, which were known to or recklessly disregarded by each of the Defendants, were:

- Defendants touted the Company as adequately capitalized, but Defendants failed to disclose to the market the Company's feeble capital position, while manipulating Freddie Mac's financial results and accounting practices in a manner designed to avoid taking losses that should have been taken in earlier reporting periods. Defendants' actions had the effect of making the Company appear more profitable than it was and distorting the truth regarding its financial health and future business prospects.

- Defendants knowingly attempted to evade the standards set forth in GAAP requiring them to record an other-than-temporary impairment in the value of Freddie Mac's ABS subprime and Alt-A mortgages securities that it classified as AFS investments in its Class Period financial statements. Defendants exploited Freddie Mac's financials, deferring losses in violation of GAAP in a desperate attempt to preserve the Company's solvency and avoid recognizing losses on such investments that would have wiped out the Company's scant financial capital.

- Defendants falsely and misleadingly used purported credit enhancements as a façade to deceptively support their highly unreasonable failure to record an other-than-temporary impairment in the value of Freddie Mac's investments in sub-prime and Alt-A securities, while at the same time knowing that the Company's primary mortgage insurers were in extreme financial distress and highly unlikely to be able to mitigate the enormous credit risk that Freddie Mac was carrying. Moreover, Defendants failed to disclose that those very insurers were rejecting claims due to fraud, which Freddie Mac's "due diligence" failed to identify, at ever-increasing rates of up to 25% of all claims.

- Defendants knew or recklessly ignored that numerous factors were in existence which indicated that it was probable that Freddie Mac would not collect all amounts due on its ABS subprime and Alt-A investments in accordance with their contractual terms, including:

- The massive diminution in the value of Freddie Mac's sub-prime and Alt-A investments during the March 31, 2008 quarter;

- Rapidly increasing defaults and delinquencies on subprime and Alt-A mortgage loans caused the values of Freddie Mac's subprime and Alt-A securities to decline precipitously during the Class Period;

- The significant increases in the severe delinquency rates of the Company's subprime and Alt-A securities and of those in the overall market; and

- Between December 31, 2007 and February 25, 2008, the credit ratings associated with more than $16 billion of Freddie Mac's AAA securities backed by subprime loans, or more than 15% of such portfolio, were downgraded below AAA by at least one nationally recognized rating agency.

529. On Sunday July 13, 2008, in advance of a Freddie Mac debt sale the following morning, the U.S. Department of the Treasury Secretary Henry M. Paulson issued a rare press release indicating the U.S. government had developed a three-part plan to ***rescue*** Freddie Mac and Fannie Mae by providing, among other things, a financial lifeline to the companies. The press release revealed, in part:

> In recent days, I have consulted with the Federal Reserve, OFHEO, the SEC, Congressional leaders of both parties and with the two companies to develop a three-part plan for immediate action. The President has asked me to work with Congress to act on this plan immediately.
>
> First, as a liquidity backstop, the plan includes a temporary increase in the line of credit the GSEs have with Treasury. Treasury would determine the terms and conditions for accessing the line of credit and the amount to be drawn.
>
> Second, to ensure the GSEs have access to sufficient capital to continue to serve their mission, the plan includes temporary authority for Treasury to purchase equity in either of the two GSEs if needed.
>
> Use of either the line of credit or the equity investment would carry terms and conditions necessary to protect the taxpayer.
>
> Third, to protect the financial system from systemic risk going forward, the plan strengthens the GSE regulatory reform legislation currently moving through Congress by giving the Federal Reserve a consultative role in the new GSE regulator's process for setting capital requirements and other prudential standards.
>
> I look forward to working closely with the Congressional leaders to enact this legislation as soon as possible, as one complete package.

530. In response to the Treasury Department's announcement, Defendants, on July 13, 2008, issued a press release wherein Syron continued to falsely assert Freddie Mac remained adequately capitalized. The press release stated, in pertinent part:

> As Freddie Mac and OFHEO Director Lockhart have affirmed, ***the company is adequately capitalized***, has a large liquidity portfolio and access to the world's debt markets. ***We are in the process of finalizing our June 30, 2008 results and we estimate that they will show we have a substantial capital cushion above the 20% mandatory target surplus established by our regulator. We expect the results will also show that we have a much greater surplus above the statutory minimum capital requirement. The company's capital and liquidity resources will enable it to continue to serve its public mission as it has always done***.

* * *

531. Then, on July 14, 2008, a litany of news articles responded to the Treasury Department and the Federal Reserve's move to rescue Freddie Mac, shedding additional light on the Company's true financial circumstances and future business prospects, as described below:

(a) The *DowJones Newswire* reported U.S. financial regulators, "in a dramatic step to help stabilize ailing Fannie Mae (FNM) and Freddie Mac (FRE), will allow the firms to borrow directly from the Federal Reserve and have proposed giving the Treasury Department the authority to take an equity stake in the companies" and that the "Treasury and Fed made clear that the federal government sees it necessary to help the firms. . . .";

(b) *Barron's* published an article entitled, "Uncle Sam Adopts Fannie and Freddie," which noted "the rescue package put forth Sunday evening puts the federal government squarely in the role of guarantor for the [Freddie Mac and Fannie Mae]." The article further noted that a cash infusion by the federal government would likely "seriously dilute the present stockholders -- perhaps to the point that their stake is worth little, as with Bear shareholders, who received a fraction of what their stock was worth just before the collapse."

(c) On that same day, the *New York Times* ran an article entitled, “Treasury Acts to Shore Up Fannie Mae and Freddie Mac” which noted, in pertinent part:

> Alarmed by the sharply eroding confidence in the nation’s two largest mortgage finance companies, the Bush administration on Sunday asked Congress to approve a sweeping rescue package that would give officials the power to inject billions of federal dollars into the beleaguered companies through investments and loans.
>
> * * *
>
> While senior Democratic and Republican officials in successive administrations have for many years repeatedly denied that the trillions of dollars of debt Fannie and Freddie issued is guaranteed, the package, if adopted, would bring the Treasury closer than ever to exposing taxpayers to potentially huge new liabilities. The two companies could face significant new losses this year as the wave of housing foreclosures continues. Officials seemed to suggest, however, that they had little choice but to intervene.
>
> * * *

(d) A *CNNMoney.com* article on July 14, 2008 entitled, “U.S. plan to save Fannie and Freddie” stated, in pertinent part:

> The Treasury Department and Federal Reserve on Sunday outlined a comprehensive government plan to prop up Fannie Mae and Freddie Mac - the two mortgage finance giants that play a crucial role in the U.S. economy.
>
> Treasury Secretary Henry Paulson said the Bush administration plans to ask Congress to enact legislation to temporarily increase the line of credit that the companies have with the Treasury. It would also allow the Treasury to buy stock in the companies.
>
> Paulson also said the Federal Reserve should be given a greater role supervising the finances of Fannie and Freddie.
>
> In addition, the Federal Reserve announced Sunday that the mortgage finance companies can turn to the Federal Reserve Bank of New York for funds. The move gives Fannie and Freddie the same access to the funds as commercial banks and Wall Street firms. The agency granted investment banks such access earlier this year in the wake of a similar crisis of confidence when investors lost faith in Bear Stearns.
>
> The decision by the government to step in comes at a tumultuous time for the two shareholder-owned companies, which own or back $5 trillion in home mortgages and are counted on to play a central role in the recovery of the battered housing market.

> At issue is the companies' financial condition and whether their balance sheets are strong enough to continue their business of buying and guaranteeing home mortgages. The plan by the Treasury and the Fed would provide Fannie and Freddie with needed capital. Beyond that, even the promise of government support could be sufficient to calm investors.
>
> * * *

(e) A July 14, 2008, *USA Today* article entitled, "Why the crisis of confidence?; Big worries surround mortgage giants Fannie Mae, Freddie Mac" pointed out the Company was reeling from a "savage week," but also revealed just how convincing Defendants' false and misleading statements and financial reporting throughout the Class Period had been. To that end, the article reported the Company was not exposed to the perils of the non-prime mortgage market:

> ***Both companies maintain fairly stringent requirements for the mortgages they buy. They don't touch subprime mortgage or many of the exotic types of loans that helped fuel the real estate bubble***. But as the mortgage market has soured, even prime borrowers – the kinds of borrowers whose loans Fannie and Freddie guarantee – have begun to default.
>
> In packaging the loans they buy, Freddie and Fannie create mortgage-backed securities. Institutional investors like these securities because they pay higher yields than Treasury securities do. And because Fannie and Freddie guarantee timely interest and principal, investors in mortgage-backed securities know they'll be paid even if borrowers default.
>
> * * *
>
> From the end of 1990 until the end of 2003, the combined portfolios of Fannie Mae and Freddie Mac catapulted from $135 billion to $1.56 trillion, according to the Federal Reserve. Together, the two companies issued nearly $3 trillion in debt.
>
> * * *
>
> Both companies insist they have enough capital to cover their losses.
>
> * * *

532. On this swelling tidal wave of negative news, the trading price for Freddie Mac common stock dropped once more, falling from $7.75 on July 11, 2008 to $7.11 on July 14, 2008 (the next trading day), a drop of approximately 8.6% on volume of more than 260,000,000 shares,

while the preferred stock fell as much as 14% per share. The Company's securities would have fallen even more but for Defendants' false and misleading statements regarding the Company's exposure to subprime and non-traditional mortgages, as well as false statements insisting the Company remained adequately capitalized and expected Freddie Mac's June 30, 2008 results to "show we have a substantial capital cushion above the 20% mandatory target surplus established by our regulator."

533. The negative news continued on July 15, 2008, when media reports were awash with stories concerning Freddie Mac's financial condition and a potential government bailout. Essentially, Defendants' false and misleading statements led to a chorus of confusion, as some in the market believed the Company was insolvent, primed for imminent collapse and in need of government intervention, while Defendants' repeated false and misleading statements regarding the strength of the Company's portfolio and capital adequacy stated the Company was strong enough to weather the tough economic storm. For example, on July 15, 2008:

(a) In an article entitled, "Jitters Persist After Rescue Moves – Paulson Drove Plan To Shore Up Fannie Mae, Freddie Mac," the *Wall Street Journal* reported Treasury Secretary Paulson had been crafting his plan to rescue Freddie Mac for weeks, but also that the Company had "passed a crucial test of investor confidence" when its sale of short-term debt on July 14, 2008 was met with strong demand, calming fears about the financial soundness of the Company.

(b) The *Wall Street Journal* also released an article entitled, "Mortgage Market Turmoil: Syron in the Hot Seat As Freddie Mac Chief," which stated, in part:

> Regulators early this year prodded Fannie and Freddie to raise more capital as losses began to mount. Both companies were reluctant to sell shares at distressed levels, diluting the interests of existing shareholders, but finally agreed to make multibillion-dollar offerings of common and preferred shares. Fannie managed to raise about $7.4 billion in April and May. Freddie promised to raise $5.5 billion but put that off

> while it tried to complete the process of registering its shares with the Securities and Exchange Commission.
>
> Freddie hoped to complete that SEC process by midyear but is waiting for final SEC approvals on its accounting policies. While Freddie was waiting, its stock price collapsed, making the effort to raise capital much more painful. Moshe Orenbuch, a Credit Suisse analyst, said Freddie erred in increasing its holdings of mortgages and related securities before raising more capital. Those holdings jumped to $770 billion in May from $710 billion in February. Freddie guarantees about $1.4 billion of mortgage securities held by others. Paul Miller, an analyst at Friedman, Billings, Ramsey & Co., said Freddie should have raised more capital late last year. ***A Freddie spokesman said the company has plenty of capital for now and will raise more when needed***.

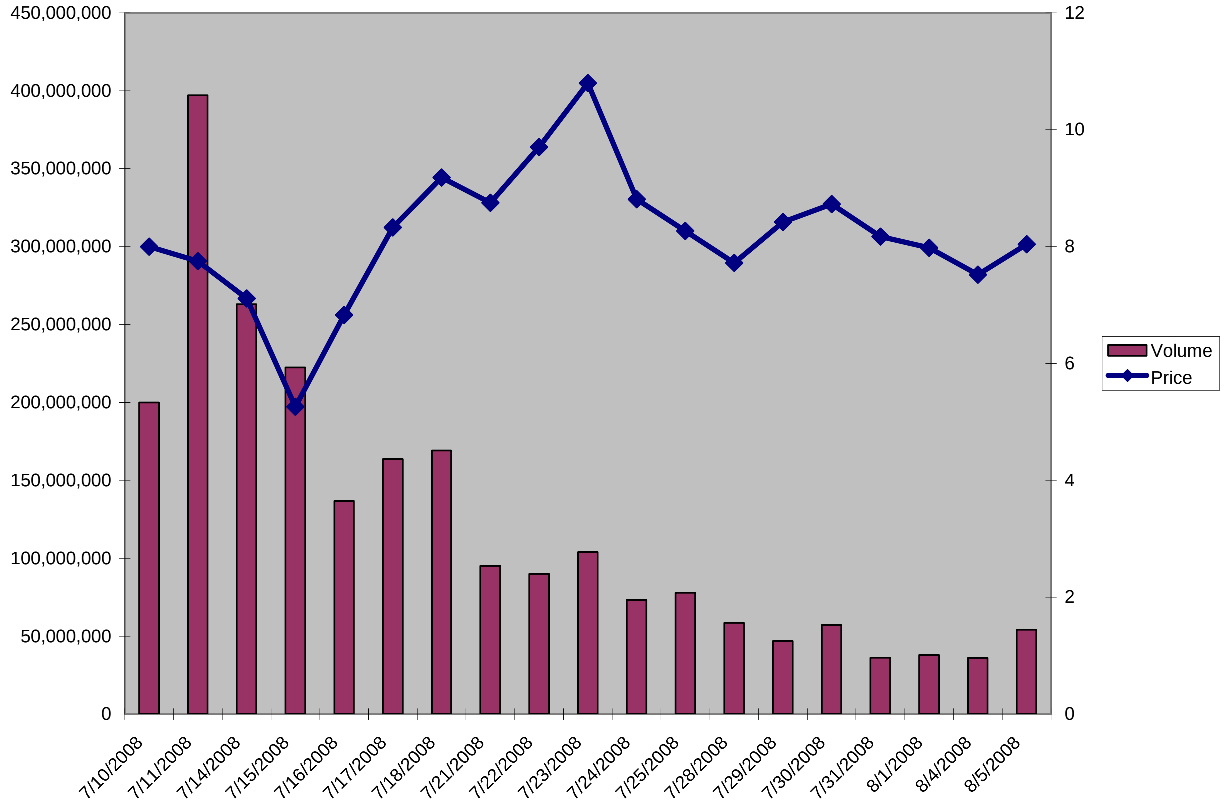
(c) The *Seattle Post-Intelligencer* reported Freddie Mac and Fannie Mae did not have to "put up" enough capital, but also "didn't do any subprime lending, because they can't. A subprime loan is precisely a loan that doesn't meet the requirement, imposed by law, that Fannie and Freddie buy only mortgages issued to borrowers who made substantial down payments and carefully documented their income."

(d) *Moody's* announced it was downgrading the Company's preferred stock and financial strength rating, and that the downgrade reflected the "diminished financial flexibility of Freddie Mac." *Moody's* also stated that market conditions "reduced Freddie Mac's ability to raise additional equity capital, thus limiting the company's ability to build further cushion to offset unanticipated stresses in its asset quality," and the downgrade of the preferred stock stemmed from an increased risk the Company could suspend dividend payments on its preferred stock.

534. Many of the articles reported there was one consensus, however, that Freddie Mac was "too big to fail." At the same time, the Company and its representatives insisted Freddie Mac was adequately capitalized. For example, on July 21, 2008, in an article in *Real Estate Finance & Investment* entitled, "Freddie Mac Sees Tighter Lending Standard But Says It's Still Active," Mitch Kiffe, the Company's Divisional Multi-Family Vice President had the following comments on the Company's capital adequacy:

> There is obviously a huge disconnect in the market. We feel, and our regulator feels, that we're well capitalized, but there are people in the marketplace who have different views. Our view is that Freddie Mac has adequate capital and, based on internal information, we will continue to have adequate capital. And so, activity in multifamily will continue at a good pace for the foreseeable future.

535. The articles made it clear that if Freddie Mac got into trouble, the government would ride in to the rescue – the implied government guarantee was now a given. Indeed, on July 24, 2008, *BusinessWeek Online* reported Freddie Mac was among "the day's biggest winners, as approval by Congress of a housing bill that would allow the government to insure up to $300 billion in mortgages neared" and there was an increased "likelihood that Treasury Secretary Henry Paulson [would] get the authority this week to inject capital into the [GSEs]." On July 30 2008, President Bush signed a bill authorizing a bailout of Freddie Mac by the taxpayers. Specifically, it provided Freddie Mac with an unlimited line of credit at the U.S. Treasury and authorized the Treasury to purchase shares in Freddie Mac, if necessary. This seemingly "positive" turn, coupled with the market confusion stemming from Defendants' false and misleading statements, caused the trading price of Freddie Mac common stock to drop by ***26%*** to close at $5.26 on July 15, 2008. Likewise, on July 14, 2008, Freddie Mac preferred shares closed down as much as 14% before dropping further on July 15, 2008, by as much as 25% per share. The trading prices of Freddie Mac common stock, however, then steadily increased in the coming weeks, reaching as high as $10.80 on July 23, 2008, as demonstrated below:



536. When the housing legislation was signed into law, it created FHFA as a new, tougher regulator for Freddie Mac. Headed by Lockhart, the FHFA combined OFHEO with the Federal Housing Finance Board. FHFA was given much more latitude than OFHEO to ensure Freddie Mac's financial well-being, including the ability to require Freddie Mac to raise more capital.

537. On August 4, 2008 article in *Real Estate & Investment Business* reported on the Company's July 18, 2008 SEC registration and capital adequacy, stating in part:

> "***Becoming an SEC registrant marks an important milestone for the company and demonstrates our commitment to enhanced transparency and financial reporting," said Chairman and Chief Executive Officer Richard F. Syron***. "It demonstrates the continued progress we've made to ***strengthen Freddie Mac's foundation and ensure that we can continue to serve our vital housing mission***. It is important to note that this registration statement does not relate to an offering of securities."

> "With this accomplishment, ***we conclude what was a difficult chapter in Freddie Mac's history*** and join the ranks of other large, public financial institutions as an

> SEC registrant," ***said Buddy Piszel***, executive vice president and chief financial officer. "Along the path to SEC registration, ***we've upgraded our internal controls and financial reporting to strengthen our business***, resulting in a return to timely quarterly financial reporting."
>
> Separately, the company reiterated that it has committed to its regulator, the Office of Federal Housing Enterprise Oversight (OFHEO), to raise $5.5 billion of new core capital through one or more offerings, which will include both common and preferred securities. The timing, amount and mix of securities to be offered will depend on a variety of factors, including prevailing market conditions, and is subject to approval by Freddie Mac's board of directors***. Preliminary indications of Freddie Mac's expected financial performance for the second quarter, while reflecting the challenges that face the industry, will leave the company expecting to be capitalized at a level greater than the 20% mandatory target surplus established by OFHEO***. As indicated in its Form 10 registration statement, Freddie Mac continues to review and consider this and other alternatives for managing its capital and maintaining regulatory compliance.

538. On August 5, 2008, more truth was revealed as the *New York Times* reported Syron rejected clear warnings from Andrukonis in 2004 that Freddie Mac was financing questionable loans that threatened its financial health. The article, entitled, "At Freddie Mac, Chief Discarded Warning Signs," stated in part:

> The chief executive of the mortgage giant Freddie Mac rejected internal warnings that could have protected the company from some of the financial crises now engulfing it, according to more than two dozen current and former high-ranking executives and others.
>
> That chief executive, Richard F. Syron, in 2004 received a memo from Freddie Mac's chief risk officer warning him that the firm was financing questionable loans that threatened its financial health.
>
> Today, Freddie Mac and the nation's other major mortgage finance company, Fannie Mae, are in such perilous condition that the federal government has readied a taxpayer-financed bailout that could cost billions. Though the current housing crisis would have undoubtedly caused problems at both companies, Freddie Mac insiders say Mr. Syron heightened those perils by ignoring repeated recommendations.
>
> In an interview, ***Freddie Mac's former chief risk officer, David A. Andrukonis, recalled telling Mr. Syron in mid-2004 that the company was buying bad loans that ''would likely pose an enormous financial and reputational risk to the company and the country.''***

Mr. Syron received a memo stating that the firm's underwriting standards were becoming shoddier and that the company was becoming exposed to losses, according to Mr. Andrukonis and two others familiar with the document.

But as they sat in a conference room, Mr. Syron refused to consider possibilities for reducing Freddie Mac's risks, said Mr. Andrukonis, who left in 2005 to become a teacher.

''He said we couldn't afford to say no to anyone,'' Mr. Andrukonis said. Over the next three years, Freddie Mac continued buying riskier loans.

Mr. Syron contends his options were limited.

''If I had better foresight, maybe I could have improved things a little bit,'' he said. ''But frankly, if I had perfect foresight, I would never have taken this job in the first place.''

Mr. Andrukonis was not the only cautionary voice at Freddie Mac at the time. ***According to many executives, Mr. Syron was also warned that the firm needed to expand its capital cushion, but instead that safety net shrank. Mr. Syron was told to slow the firm's mortgage purchases. Instead, they accelerated***.

Those and other choices initially paid off for Mr. Syron, who has collected more than $38 million in compensation since 2003.

But when housing prices began declining in 2006, choices at Freddie Mac and Fannie Mae proved disastrous. Stock prices at both companies have fallen by more than 60 percent since February, destroying more than $80 billion of shareholder value.

More than two dozen current and former high-ranking executives at Freddie Mac, analysts, shareholders and regulators said in interviews that Mr. Syron had ignored recommendations that could have helped avoid the current crisis.

Many of those interviewed were given anonymity for fear of damaging their careers by speaking publicly.

Now, some outsiders are saying that Mr. Syron and the top executive at Fannie Mae -- some of the highest-profile figures in the business world -- should be replaced.

''The top people should be booted out, and replaced by executives who have the confidence of the markets,'' said Janet Tavakoli, a finance industry consultant and observer of both firms. Large Freddie Mac shareholders, speaking on the condition of anonymity, echoed those sentiments.

Mr. Syron and the Fannie Mae chief executive, Daniel H. Mudd, ***defended their choices, saying in interviews that they did not anticipate that the housing market would decline so quickly*** and that they were buffeted by conflicting pressures.

‘‘This company has to answer to shareholders, to our regulator and to Congress, and those groups often demand completely contradictory things,’’ Mr. Syron said in an interview.

Indeed, executives of both companies maintain that ***one of the reasons the firms hold so many bad loans*** is that Congress has leaned on them for years to buy mortgages from low-income borrowers to encourage affordable housing. In 2004, Freddie Mac warned regulators that affordable housing goals could force the company to buy riskier loans.

Others, however, dismiss that explanation. ‘‘Sure, it’s hard to deal with the pressures of Congress and shareholders and regulators,’’ said a former high-ranking Freddie Mac executive. ‘‘But that’s why executives get paid so much. ***It’s not acceptable to blame those pressures for making bad choices***.’’

In a statement, Freddie Mac said executives were unable to verify that Mr. Andrukonis’s memorandum existed, and that the company’s default and delinquency rates were substantially lower than other firms. ***‘‘There is little to nothing that Freddie Mac could have done to prevent the losses that it is now incurring,’’ wrote company spokesman, David R. Palombi***.

* * *

Mr. Syron and Mr. Mudd eventually yielded to those pressures, effectively wagering that if things got too bad, the government would bail them out.

‘‘The thinking was that if something really bad happened to the housing market, then the government would need Freddie and Fannie more than ever, and would have to rescue them,’’ Mr. Andrukonis said. ‘‘Everybody understood that at some level the company was putting taxpayers at risk.’’

Representatives of Mr. Syron and Mr. Mudd said the firms never made choices assuming the government would intervene. Both said they balanced shareholder and Congressional demands against market realities.

For years, the companies collected rich profits. But some executives grew increasingly concerned.

Mr. Andrukonis wrote his memo in 2004. At the time, he also briefed the risk oversight committee of the board of directors, but did not share his memo with them, he said. A member of that committee declined to return phone calls.

Soon thereafter, Freddie Mac’s head of capital compliance and oversight, Donald Solberg, counseled Mr. Syron to maintain a thick capital cushion, according to multiple people familiar with those discussions. Mr. Solberg continued making that recommendation until early 2007, when he left the company. Mr. Solberg declined to comment on his conversations.

Last year, Treasury Secretary Henry M. Paulson Jr. and the Federal Reserve chairman, Ben S. Bernanke, privately urged both companies to raise more money*. *At one point, Mr. Bernanke threatened to publicly scold the companies if they did not raise more cash.

Beginning in November, Fannie Mae raised $14.4 billion from shareholders over a six-month period.

But Mr. Syron was more resistant*. *Freddie Mac raised $6 billion in preferred stock last year, but at a March conference in New York, Mr. Syron combatively dismissed suggestions he would raise more simply because officials told him to.

''This company will bow to no one,'' Mr. Syron told a room of investors and analysts. Despite promises, the company has delayed a planned $5.5 billion stock sale. Because of that delay, the effective cost of raising funds has skyrocketed as the company's share price has declined.

In a statement, Freddie Mac said Mr. Syron's March comments focused on dilutive capital raising and that the stock sale was delayed because lawyers said it could not occur while the company was registering with the Securities and Exchange Commission. That process was finalized last month.

In ***2007, as home prices were falling and defaults rising in some areas, people at both firms urged their chief executives to scale back on mortgage purchases***. Fannie Mae shrunk its mortgage portfolio slightly.

Mr. Syron's Freddie Mac, however, increased its portfolio by $17 billion.

That same year the companies posted combined losses of $5.2 billion. This year, they have announced losses of $2.4 billion, and analysts say they may lose an additional $24 billion or more.

Last month, after weeks of rumors and bad news, investors began dumping the companies' shares, driving their stock prices down almost 60 percent apiece. The selling did not subside until Mr. Paulson unveiled a rescue plan with powers to inject billions of taxpayer dollars into the companies. That plan has not been activated, but the law, signed by President Bush last week, also gives the government sweeping new regulatory control over the firms.

''It basically worked exactly as everyone expected -- when things got bad, the government came to the rescue,'' said a second former high-ranking Freddie Mac executive. ''But we didn't expect it would come at the cost of a new regulator who now has the power to burrow into our business forever.''

In the last three weeks, the companies' stock prices have recovered a small portion of their losses. Executives, however, remain concerned that more bad news could spark another panic.

> Freddie Mac will report its second-quarter financial results Wednesday. Fannie Mae will release its results on Friday.
>
> ''I've had four other jobs as C.E.O., and I came out of them all pretty well,'' Mr. Syron said. ''What I'm working for right now is to save my reputation.''

539. Following publication of the *New York Times* article, the Company issued a press release entitled, "Freddie Mac Responds to the New York Times." In the press release, Defendants made numerous false and misleading statements – the falsity of which was subsequently revealed in, among other things, Congressional testimony and documents. For example, the Company falsely claimed it could not confirm the existence of Andrukonis' warnings to Syron and falsely claimed it remained adequately capitalized. The press release stated, in part:

> Charles Duhigg's story ("At Freddie Mac, Chief Discarded Warning Signs," August 5) fell far short of the standards New York Times readers have every right to expect from the paper. Given the consequence of the subject, readers deserved more than a superficial tale spun on the purported comments of a collection of anonymous former employees and unspecified "others" likely including the well-worn band of ideologues and self-interested detractors who have opposed the GSE model for years.
>
> Readers deserve more. The story is apparently based on the word of David Andrukonis, a former employee who was involuntarily terminated in 2005. ***It describes a memorandum one we can't confirm the existence of, one we don't believe Mr. Syron ever saw***, and one that Mr. Duhigg never produced for us. Although the reporter was aware of these facts, he cited the individual's account without mentioning them, instead portraying the former employee as having left amicably to become a schoolteacher.
>
> Readers also deserve more than a highly selective cherry-picking of quotes from extensive interviews and information the reporter received over several hours and weeks, including interviews with Mr. Syron. For example, he chooses to ignore completely Mr. Syron's main challenge when he joined Freddie Mac: that the company had treated its mission of improving affordability as a tax, rather than as a core responsibility that the firm should embrace.
>
> In fact, a full review of the facts makes clear that Freddie Mac has helped to keep a bad situation in the housing market from becoming even worse.
>
> There is ample public record of the significant effort that Freddie Mac and its management team put in to balance its public mission with its commitment to safety and soundness a record that was shared with your reporter.

This result of our efforts to manage risk prudently is that we exceed our regulatory capital standards and remain highly liquid in the midst of the single largest decline in real estate values since the Great Depression, ***with a cushion above the 20% mandatory target surplus established by our regulator***.

As a mono-line company focused solely on U.S. home mortgages, Freddie Mac is of course experiencing higher losses as home prices decline and defaults increase just like every other financial institution with exposures to mortgages. Contrary to the facts the reporter was given and the impression he sought to create.

While, in hindsight, there are some loan practices it would have been better if we had avoided, nonetheless our mortgage default and credit loss rates are a fraction of the industry averages. ***That's because when we decided to expand our activities, we did it in a very prudent and surgical way*** relative to others. ***With few exceptions, we enabled families to buy homes they could afford and are still enjoying today***.

Our losses could have been even lower had it not been for the need to balance our exposures with our affordable housing goals and the company was transparent about this. For example, it is a matter of public record that when the U.S. Department of Housing and Urban Development made the decision to raise the affordable housing goals for Freddie Mac and Fannie Mae in 2004, we warned that moving forward with the higher goals would cause a relaxing of underwriting standards. As we pointed out to the Times, but they chose not to include, the Federal Register of November 2, 2004 notes that we "cautioned that the struggle to meet high goals for low-income groups could cause the GSEs to relax underwriting standards and/or extend loans to people who are unprepared."

At absolutely no time did we "wager" as the reporter suggested "that if things got too bad, the government would bail [us] out." As our spokesman said, we never made choices assuming the government would intervene. Moreover, as Mr. Syron and other members of management have made clear repeatedly including at the company's investor day in New York in March we have an obligation to balance safety and soundness, mission and our fiduciary duty to shareholders.

The story portrays capital management as a series of simple right or wrong, "go" or "no go" decisions, when it too is a balancing act. ***Last year, Freddie Mac raised $6 billion in capital and our safety-and-soundness regulator, the Secretary of the Treasury and the Federal Reserve Chairman have reiterated that we have sufficient capital and are financially sound this is before we meet our commitment to raise an additional $5.5 billion***.

The reporter bizarrely characterized our not raising this second round of capital as some kind of pique of defiance. Nothing could be further from the truth. As we told the reporter, while our CEO and senior management team wanted to raise that capital quickly, our own internal and external legal counsel, counsel to the Board and our bankers and counsel to our bankers advised us of the significant risk of commencing

> a public offering due to the timing of the second quarter release and until after we completed our registration with the SEC, which we have since done.
>
> As a government-sponsored enterprise, Freddie Mac serves an essential national public policy mission to help support America's mortgage finance markets, operates safely and soundly, and fulfills its fiduciary responsibilities to investors. Maintaining the right balance between sometimes conflicting demands requires constant vigilance and judgment day in and day out as financial markets go up and down, competitors come and go, opponents attack and innovations drive product and process changes at an ever-increasing pace. But the decisions we made were based on business judgments that were carefully considered based on all of these factors.
>
> We continue to perform the mission with which Congress charged us: providing critically needed liquidity and stability to the mortgage market. While others have fled the market, Freddie Mac and Fannie Mae remain virtually the only major sources of mortgage liquidity. In much of the home mortgage market, investor capital dried up as the collapse of the subprime mortgage market led to a broader loss of confidence in the financial markets but not for those we insure. For example, rates on the conforming home mortgage market traditionally served by the GSEs remain healthy, even as those on jumbo home mortgages skyrocketed. Only when Congress gave the GSEs temporary authority under the economic stimulus package to buy some jumbo loans in high-cost areas did rates on these jumbo loans fall.
>
> Throughout our history, we have striven to serve our mission, maintain our financial strength and provide investors value so that they will continue to provide the capital underpinning the nation's housing markets. ***We are clearly capable and intend to continue to serve this mission going forward.***

540. Defendants' false and misleading statements in response to the *New York Times* article had their intended effect. The Company continued to mislead the market as to its capital adequacy and claimed it always approached risk in a surgical way. Faced with competing revelations and false statements, market expectations remained inflated and the trading price of Freddie Mac common stock did not drop. Had Defendants not continued to mislead the market with false and misleading statements, the trading price of Freddie Mac common stock would have dropped.

541. The statements referenced in ¶¶530, 537, and 590 were each materially false and misleading when made for the reasons set forth in ¶452 and the factual detail contained throughout this Complaint. In addition, the statements referenced in ¶¶530, 537, and 590 were materially false

and misleading when made because they represented and/or omitted adverse facts which then existed and disclosure of which was necessary to make the statements not false and/or misleading. The true facts, which were known to or recklessly disregarded by each of the Defendants, were:

- Defendants touted the Company as adequately capitalized, but Defendants failed to disclose to the market the Company's feeble capital position, while manipulating Freddie Mac's financial results and accounting practices in a manner designed to avoid taking losses that should have been taken in earlier reporting periods. Defendants' actions had the effect of making the Company appear more profitable than it was and distorting the truth regarding its financial health and future business prospects.

- Defendants knew that OFHEO, the Treasury Department and the Federal Reserve – like the market – were unaware that the $6 billion raised by the Company was insufficient to keep the Company afloat because Freddie Mac was saddled with undisclosed, massive, unavoidable, other-than-temporary impairments on its subprime, other non-prime, and non-traditional mortgage related assets.

- Though Defendants stated during the Class Period that they expanded their mortgage portfolio "in a prudent and surgical way," Defendants knew, and hid from the market, that they had steamrolled into the non-prime, non-traditional loan market without adequate safeguards, sufficient quality control standards or accounting and computing systems capable of determining credit risk and categorizing these new types of extremely risky loans. For instance, during the Class Period, Defendants failed to disclose each of the following material facts to the market:

    - By 2006, the Company stopped using its own underwriting guidelines in many instances and began using those of so-called "inferior" mortgage lenders;

    - The only due diligence conducted on loans from some of the Company's largest lenders despite the fact that the only due diligence conducted on those loans was done through the lenders' own automated underwriting systems;

    - Freddie Mac began conducting fewer and fewer upfront quality control samplings of loans over time. Instead, the Company depended on the Freddie Mac Quality Control department to sample 100% of loans ***after default*** rather than making use of sampling upfront; and

    - Freddie Mac computing software was antiquated and had been unable to accurately process many of the new types of exotic loans that the Company had devoured.

542. On August 6, 2008, the falsity of Freddie Mac's financial reporting, as well as large portions of its true financial condition and the gross inadequacy of its capital reserves, were further

partially revealed. On that date, Freddie Mac issued its Financial Report for the Three and Six Months Ended June 30, 2008 (the "August 6, 2007 Financial Report") along with an accompanying press release.

543. Included in the second quarter loss were mark-to-market losses of $2.3 billion related to the Company's trading securities. The second quarter loss also included security impairments on the Company's available-for-sale securities of approximately $1.0 billion for the second quarter of 2008. Of this amount, $826 million was related to non-agency mortgage-related securities backed by subprime or Alt-A and other loans, due to deterioration in the performance of the collateral underlying these securities.

544. Additionally, the Company's credit-related expenses – consisting of provision for credit losses and Real Estate Owned operations expense – doubled to $2.8 billion for the second quarter of 2008, from $1.4 billion for the first quarter of 2008. The Company also advised shareholders on August 6, 2008 that, subject to approval by its Board of Directors, the Company would reduce the dividend on its common stock in the third quarter of 2008 from $0.25 to $0.05.

545. On the Company's earnings conference call following the release of the August 6, 2008 Financial Report, Cook discussed the credit quality of Freddie Mac's guarantee book of business, noting that "credit losses continue to accelerate in our single-family g-fee business, and are highly concentrated in a portion of the portfolio." Cook also revealed to the market that the Company's loan portfolio was not nearly as low risk as Defendants had intimated during the Class Period:

> While we may be roughly half way through the eventual decline, we are still in the early stages of realized defaults. Since the beginning of 2007 through the second quarter, we have only realized about $2 billion in credit losses. So most of the expected losses are yet to be realized…

* * *

546. Later on the call, Cook revealed to investors what the Defendants had known all along – that the loans in the lowest quintile of the Company's Alt-A portfolio were not performing like Alt-A at all, but rather were becoming delinquent at a much higher rate [a delinquency rate that was very similar to the delinquency rate for what the mortgage lending industry and bank regulators (but not Freddie Mac) would characterize as "subprime loans"]:

> Let's look at what we know. We know that the Alt-A book has generated about 50% of the year-to-date losses. And on a vintage basis, we know that the 2006 and 2007 book have generated about 60% of the losses. A look at the delinquency rates in these cohorts and the remaining portfolio will allow us to make some assessments about the future.
>
> A close look at the Alt-A portfolio reveals significant differences between it and the total Alt-A market. The bottom quintile of Alt-A has a 90-plus day delinquency rate of 11.4%. The remaining 80% has a serious delinquency rate of 2.2%. The bottom quintile has credit characteristics that are much worse in the remaining population. Most of it was originated through out bulk channel, which indicates products outside our standard guide. While some of the loans in the remaining 80% were also originated through the bulk channel, a significant portion was originated through our flow contract.
>
> The overall credit statistics for the two cohorts are very different. Here is a summary of how these two cohorts compare. The average FICO of the bottom quintile is 696 versus 731 for the remaining 80%. Average CLTV 95% versus 73%, arms, 93% versus 30%, and interest only, 86% versus 23%. While we were able to charge more for these loans than our standard flow loans, the fees proved insufficient for these increase in realized losses. As a result of these very different credit profiles, it is logical to use different expected levels of default and severities for these two components of the portfolio.
>
> As you can see in the blue boxed portions of slide 12, we would expect the bottom quintile of Alt-A to default at a much higher level than the remaining 80%. In a very stressful scenario, a 50% default rate, which is about four times today's serious delinquent population, and 50% severities, would produce about $10 billion in EDC. A 10% default rate and a 45% severity for the remaining 80% of the population would produce a $7 billion loss.

547. Cook also revealed to investors that the loans in the newer books of what Defendants called the "prime portfolio" were becoming delinquent at a much higher rate than the loans in the books for the years 2005 and before:

> Similarly, in the prime portfolio shown in the blue-boxed area of slide 12, there is a significant difference between the 2005 and prior book compared to the rest of the portfolio. This is due in part to the lower CLTV on the earlier book of approximately 57% versus 78% on the later vintages, which likely contributes to a lower delinquency rate today and likely will result in lower defaults over the life of the book.

* * *

548. The additional partial revelations in the two preceding paragraphs were admissions to the market that Defendants' representations prior to August 6, 2008, indicating the Company had limited subprime exposure and a low risk portfolio were false and misleading when made.

549. Notwithstanding the new revelations concerning Defendants' Class Period false and misleading statements, Defendants continued to impress upon the market during the earnings conference call that the Company was well-capitalized and sustainable:

> **<u>Dick Syron – Freddie Mac Chairman and CEO</u>**
>
> Nonetheless, the basic equation we gave you on our last call remains true. We said credit would continue to deteriorate, and it has, admittedly even faster than we thought. *We also expect weaker credit to be mitigated in part by strong revenue growth*. And, indeed, net interest income grew even more rapidly than we had projected.
>
> * * *
>
> ***Another constant has been our ability to keep serving our mission and our customers at a time when the markets, policy makers and US homeowners are depending on us a great deal for the health of the economy***.
>
> * * *
>
> ***Despite increased credit costs, Freddie Mac ended the quarter with approximately \$37 billion in capital***. That's about \$2.7 billion above our 20% mandatory target surplus, and \$8.4 billion above the statutory minimum requirement. In order to provide additional flexibility in our capital planning, and subject to board approval, we will be reducing our common dividend from \$0.25 to \$0.05 or less. I should note that we intend to pay full dividends at the contractual level on our preferred stock.
>
> * * *
>
> In closing, I think you can derive three main themes from today's call. One, credit quality is today's overriding issue for financial service companies everywhere. And

as you know, none of us is immune. ***Two, we're working to manage our credit risk prudently, and we'll be taking considered steps to strengthen our capital position. Three, we're also focusing successfully on growing revenue and managing costs to insure a strong foundation for long term growth and profitability***.

Buddy Piszel – Freddie Mac CFO

* * *

Slide five summarizes our credit results from the past several quarters. ***And as you can see, while credit has clearly deteriorated, we have consistently provisioned well in excess of emerging charge-offs. As a result, we believe that we remain appropriately reserved for our estimated incurred losses***. Our reserve to annualize second quarter charge-offs is about 2.7 times compared to about 3 times in the first quarter.

* * *

Let's move to capital. On slide ten, this shows that at the end of June, we had a capital surplus of $2.7 billion above the 20% surplus requirement. As part of our first quarter earnings release, we discussed that at that point we had estimated a need for about $5.5 billion in new capital. Since that time, we have continued to refine our analysis. And the bullet points on the lower section of the slide convey the sources of financial flexibility that we have.

First, we are starting with a capital surplus of $2.7 billion over the 20%, and $8.4 billion over our statutory minimum. Second, we expect continued strong revenue growth and the restoration of earnings from the reversal of prior period mark to market and impairment charges.

* * *

To sum up, while credit has definitely worsened, ***growth in our revenues, a significant reserve build, flexibility on capital, and a capital raise of $5.5 billion gives us confidence that, even under severe emergence of losses, we expect to maintain a surplus above our statutory minimums through the end of '09. So we have the wherewithal and the earnings power to manage through this period and emerge a strong long-term competitor***.

* * *

Patti Cook – Freddie Mac Chief Business Officer

* * *

So in summary, we continue to absorb and predict large credit losses. ***However, we believe they are manageable, and under any realistic scenario I hope the analysis we have presented here today has reinforced that message…***

*   *   *

550. During the question and answer session of the August 6, 2008 earnings conference call, Defendants made additional false and misleading statements:

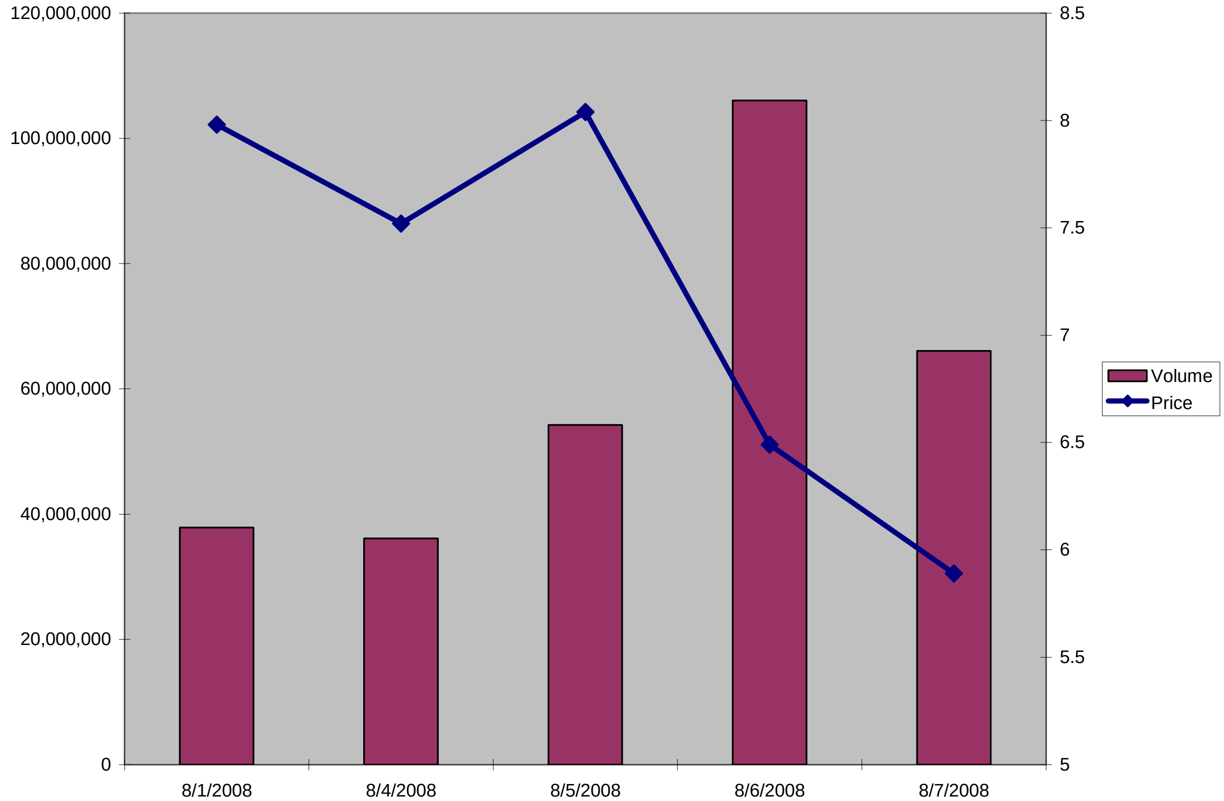
> **<u>Bob Napoli – Piper Jaffray & Co. Analyst</u>**
>
> Thank you. Two questions. First, on the capital side, why did you hold off at the end of last quarter, and how long can you wait? I mean you have $2.7 billion of excess regulatory capital. Can you run that down for a couple quarters, down near--where can you take that before you go out and raise money?
>
> *   *   *
>
> **<u>Buddy Piszel – Freddie Mac CFO</u>**
>
> ***Yes, Bob, as to where we are and how quickly we have to move, we have 2.8 over the 20% right now. We believe we can manage to maintain our capital position for some time***. So we are not putting a date certain. And we're certainly poised and ready when market conditions are appropriate. But there is no need for us to rush.
>
> **<u>Bob Napoli – Piper Jaffray & Co. Analyst</u>**
>
> You think you can maintain the 2.8 at that level for some time, or --?
>
> **<u>Buddy Piszel – Freddie Mac CFO</u>**
>
> ***There is flexibility to be in that zone [for] a while***.
>
> *   *   *
>
> **<u>Gary Gordon – Portales Partners Analyst</u>**
>
> Thanks. Follow up is on capital. You talked about when you were going over capital you were looking at the minimum capital standard as opposed to your full well-capitalized level. There is obviously a big zone in there. Does something happen if you go below your well-capitalized level that impact your behavior?
>
> **<u>Dick Syron – Freddie Mac Chairman and CEO</u>**
>
> There probably is. We are not, by using that benchmark to develop these tables, implying, in any sense, that we intend to get down to the minimum capital level. ***The story is that we're now operating at a 20% surplus level over the minimum capital levels***. There were various negotiations and agreements on what that number would be once we raised $5.5 billion. So you essentially have a moving target here.
>
> *   *   *

551. Later on the call, Cook falsely asserted that the worst quintile of Alt-A loans – which were now becoming delinquent at rates similar to subprime loans – were consistent with the Company's charter and underwriting guidelines:

> **<u>David Hochstim – Buckingham Research Group Analyst</u>**
>
> Patti, on slide 12, when you showed the sensitivity to losses, the worst 20% of the Alt-A portfolio, is there anything in those loans in terms of underwriting that didn't meet guidelines that would allow you to put more of those loans back and reduce your ultimate credit losses? Or are those, just everything came through LP and just turned out they were bad?
>
> **<u>Patti Cook – Freddie Mac Chief Business Officer</u>**
>
> No, those loans don't reflect a high probability of loans that we would be repurchasing. We have already taken that into account when we show you these statistics. Rather, what I'd say about that population is that there were a variety of considerations at the time when we looked at that portfolio. Combination of market share, mission, that we balanced when we made those decisions. So, clearly, in retrospect, that $38 billion of loans is not performing necessarily the way we would have liked. ***But nonetheless they are all consistent and meet our charter and guideline requirements***.

* * *

552. The market's reaction to the partial revelation of the Company's true financial condition and future business prospects was swift and severe. On August 6, 2008, the trading price of Freddie Mac common stock plummeted to a closing price of $6.49, representing a drop of more than 19% on trading volume of more than 100,000,000 shares, while the Company's preferred stock fell as much as 11%. The common stock fell again the following day, dropping another 9% to close at $5.89 per share, while the preferred shares fell as much as 10% per share. The drop in the trading price of Freddie Mac common stock is demonstrated below:



553. The statements referenced in ¶¶549-51 were each materially false and misleading when made for the reasons set forth in ¶452 and the factual detail contained throughout this Complaint. In addition, the statements referenced in ¶¶549-51 were materially false and misleading when made because they represented and/or omitted adverse facts which then existed and disclosure of which was necessary to make the statements not false and/or misleading. The true facts, which were known to or recklessly disregarded by each of the Defendants, were:

- Defendants knew that notwithstanding their Class Period statements that all the loans the Company had purchased were consistent with Freddie Mac's charter and met the Company's guideline requirements, in fact, in each of 2005, 2006, and 2007, 50% or more of the Company's single family purchases consisted of subprime, Alt-A, or other non-prime loans or securities, with the result being that 35% of its entire single-family credit exposure consisted of such high risk loans or securities – loans and securities that were not consistent with the company's charter and guideline requirements. Furthermore, during each year from 2002 through 2006, Freddie Mac's underwriting and quality control standards got significantly looser in pursuit of a higher volume of loans.

- Defendants knew that their credit losses were not manageable under any reasonable scenario, and, in fact, that the Company's credit losses had put Freddie Mac in such a precarious financial position that Defendants chose to manipulate Freddie Mac's financial results and accounting practices in a manner designed to avoid taking losses that should have been taken in earlier reporting periods.

554. As set forth above, although Defendants indicated the Company could fall below government-mandated capital levels, Defendants continued to mislead the market as to the Company's true capital adequacy, spinning and minimizing the impact of the bad news as they had throughout the Class Period. For example, on August 6, 2008, *MarketWatch* reported that "Freddie's Chief Financial Officer Buddy Piszel said the company is capitalized above regulatory requirements and has 'open access' to the debt markets. He said the company can withstand $40 billion in credit 'pain' this year and in 2009, and still maintain its regulatory capital requirement." In the same report, Syron stated, "While we expect continued housing and economic weakness will affect our overall performance this year, we continue to maintain a surplus over all regulatory capital requirements" and "remain committed to raising $5.5 billion in new capital and will evaluate raising capital beyond this amount depending on our needs and as market conditions mandate." In the *Wall Street Journal* on August 7, 2008, Piszel signaled the Company was on sound capital footing when he was quoted as saying, "There's no need for us to rush [to raise additional capital]." Thus, despite all the negative news, Defendants continued to falsely inflate market expectations that the Company had adequate capital to weather the housing storm, and that it had the ability to raise additional capital if needed.

555. On August 16, 2008, *Barron's* published an article entitled, "The Endgame Nears for Fannie and Freddie," which stated, in part:

> It may be curtains soon for the managements and shareholders of beleaguered housing giants Fannie Mae and Freddie Mac. ***It is growing increasingly likely that the Treasury will recapitalize Fannie and Freddie in the months ahead on the taxpayer's dime, availing itself of powers granted it under the new housing bill signed into law last month***. ***Such a move almost certainly would wipe out existing***

holders of the agencies' common stock, with preferred shareholders and even holders of the two entities' $19 billion of subordinated debt also suffering losses. Barron's first raised the possibility of a government takeover of Fannie and Freddie in a March 10 cover story, "Is Fannie Mae Toast?"

*   *   *

Similarly, the balance sheets of both companies have been destroyed. On a fair-value basis, in which the value of assets and liabilities is marked to immediate-liquidation value, ***Freddie would have had a negative net worth of $5.6 billion*** as of June 30, while Fannie's equity eroded to $12.5 billion from a fair value of $36 billion at the end of last year. That $12.5 billion isn't much of a cushion for a $2.8 trillion book of owned or guaranteed mortgage assets.

What's more, the fair-value figures reported by the companies may overstate the value of their assets significantly. By some calculations each company is around $50 billion in the hole.

*   *   *

Besides, the agencies claim they've landed in their current predicament through no fault of their own. As Freddie Mac Chairman and CEO Richard Syron recently put it, the GSEs have been hit by a "100-year storm" in the housing market, accentuated by some higher-risk mortgages that they were forced to buy to meet government affordable-housing targets.

The latter contention is more than disingenuous. A substantial portion of Fannie's and Freddie's credit losses comes from $337 billion and $237 billion, respectively, of Alt-A mortgages that the agencies imprudently bought or guaranteed in recent years to boost their market share. These are mortgages for which little or no attempt was made to verify the borrowers' income or net worth. The principal balances were much higher than those of mortgages typically made to low-income borrowers. In short, Alt-A mortgages were a hallmark of real-estate speculation in the ex-urbs of Las Vegas or Los Angeles, not predatory lending to low-income folks in the inner cities.

*   *   *

An insider in the Bush administration tells *Barron's* Fannie and Freddie are being jawboned by the Treasury Department and their new regulator, the Federal Housing Finance Agency (FHFA), to raise more equity. But government officials don't expect the agencies to succeed. For one thing, only a "capital raise" of $10 billion or more apiece would have any credibility. Yet, what common-stock investors would advance that kind of money to entities that have market capitalizations of $8.5 billion (Fannie) and $4 billion (Freddie), especially as the FHFA will use its new powers to boost dramatically the regulatory capital the GSEs must have in coming years?

*   *   *

Should the agencies fail to raise fresh capital, the administration is likely to mount its own recapitalization, with Treasury infusing taxpayer money into the enterprises, according to our source. The infusion would take the form of a preferred stock with such seniority, dividend preference and convertibility rights that Fannie's and Freddie's existing common shares effectively would be wiped out, and their preferred shares left bereft of dividends. Then again, the administration might show minimal kindness to preferred shareholders; local and regional bankers have been lobbying the Bushies not to wipe out the preferred since the bankers own a lot of that paper and rely on the bank preferred-stock market for much of their own equity capital.

An equity injection by the government would be tantamount to a quasi-nationalization, without having to put the agencies' liabilities on the nation's balance sheet, and thus doubling the U.S. debt. Treasury would install new management and directors at both, curb the GSEs' sometimes reckless investment and guarantee operations, and liquidate in an orderly fashion the GSEs' troubled $1.6 billion in on-balance-sheet investments. Then the companies could be resold to the public without their explicit government debt guarantees, or folded into government agencies like Ginnie Mae or the FHA.

* * *

According to our source, both agency managements seemed amenable to the March deal, though they demurred on raising new capital immediately. They thought, and Treasury agreed, that any share flotation would have to wait until May, when first-quarter earnings were scheduled to be announced, providing investors with material information. Come May, Fannie kept its side of the bargain by raising $7.2 billion in mostly common equity. But Bush officials were shocked when Freddie failed to follow suit on an announced $5.5 billion equity raise.

According to our source, Freddie's Syron offered a variety of excuses. He said neither he nor several senior board members wanted to dilute current shareholders since the stock had fallen from 67 in the summer of 2007 to around 25 in May. He also insisted Freddie could do nothing on the core capital front until it had completed its formal corporate registration with the SEC under the 1934 Act. That argument seemed fishy, since Freddie had raised $6 billion in preferred capital the previous November, and like Fannie has an exemption from registering stock issues with the SEC. A Freddie Mac spokesperson says the company was acting according to legal advice.

Freddie succeeded in exploiting the Prague Spring of regulatory forbearance. Monthly statements show it bought even more mortgages, gunning the growth in its retained, on-balance-sheet portfolio by 11% in the second quarter. By reducing its hedging costs, it also doubled its vulnerability to loss from interest-rate moves. It appears Freddie was hoping a Hail Mary Pass with the portfolio would somehow reduce its spiraling operating losses.

In retrospect, the agency meltdown seemed inevitable as the housing crisis deepened and credit losses mounted. On July 7 an analyst report claimed both agencies might have to raise substantially more capital because of a change in accounting regulations. Both stocks went into free fall, tumbling nearly 50% on the week.

* * *

In the weeks since, Freddie has continued to put off raising capital, even though it finally completed its registration as a corporation with the SEC. Syron said when second-quarter earnings were released Aug. 6 that the company was waiting for a more "propitious" time. One might argue it came in May, when the stock was 25, not 6.

Both GSEs continue to note their so-called core or regulatory capital levels remain comfortably above the minimum required by federal regulation. This ignores what would happen, however, if their balance sheets were marked to fair value -- or if their fair-value estimates were hugely inflated, as indeed may be the case. ***Both balance sheets, for one, contain an entry called deferred tax assets that bulks up Fannie's fair-value net worth by $36 billion and Freddie's by $28 billion. These assets don't represent real cash but tax credits the agencies have built up over the years that can be used to offset future profits. But, since the tax assets can't be sold to a third party, or disappear in a receivership or sale of the company, they are disallowed in the capital computations of most financial institutions***. Ironically, the worse a company does, the more capital cushion this asset creates.

The companies also appear to have boosted their capital ratios by sharply curtailing their repurchase of soured mortgages out of the securitizations they've guaranteed. ***In the fourth quarter of last year, for instance, Freddie Mac took a loss of $736 million on loans repurchased. In this year's first quarter that figure dropped to $51 million -- a stunning decline in view of the continued deterioration of the housing and mortgage markets. Instead, the company made the interest payments to bring the mortgages current -- a much smaller outlay, but a tactic that only pushes an inevitable loss forward into future quarters.*** In Fannie's case, by postponing the buyback of bad loans the company avoided more than $1 billion in second-quarter charge-offs and a hit to its net worth.

Other numbers also give pause. Less generous marks to Freddie's $132 billion investment holdings in private-label subprime and Alt-A securities would lop another $20 billion off its net worth. And, more than likely, Fannie's credit reserves of $8.9 billion won't fully protect it from future losses on $36 billion of seriously delinquent mortgages on its $2.8 trillion book.

After accounting for deferred tax assets and generous asset marks, Fannie and Freddie each may have a negative $50 billion in asset value, and little prospect of digging themselves out of the hole. Whether Fannie and Freddie are liquidated or nationalized as a prelude to privatization, in their current form they won't be missed.

556. The additional partial revelations in the *Barron's* article immediately impacted market expectations for Freddie Mac. Once again, the market was dogged by revelations the Company was essentially insolvent and headed for a bailout and government takeover that were contrasted with Defendants' statements the Company was adequately capitalized and, importantly, able to raise additional capital if necessary. In response to the *Barron's* article, Freddie Mac common stock dropped from a close of $5.85 on August 15, 2008 (the prior trading day) to a close of $4.39 on August 18, 2008 (the following trading day), a drop of 25%, while the preferred stock fell as much as 26%.

557. From this point on, speculation as to Freddie Mac's fate persisted in the marketplace. Commentators wondered aloud whether the Company could stand on its own – indeed, Defendants claimed it could – or whether naysayers were correct that the Company had reached its endgame. Such speculation left the market in limbo, with expectations diminished, but inflated nonetheless by Defendants' persistent claims of viability and capital ability.

558. Indeed, on August 20, 2008, *Bloomberg* published an article entitled, "Fannie, Freddie Bailouts May Hinge on Debt Rollover," stating the Company's success in repaying billions of bonds due by the end of the quarter would determine whether it could avoid a federal bailout. The article reported, in part:

> Freddie paid its highest yields on record in a debt sale yesterday amid concern that credit losses are depleting the capital of the beleaguered mortgage-finance companies.
>
> Rolling over the [bond] debt "is the single most important factor to their ability to remain liquid," said Moshe Orenbuch, an analyst at Credit Suisse in New York. "So far, they've been able to do that."
>
> * * *
>
> ***Freddie Mac "continues to have strong access to the debt markets at attractive spreads," [Freddie Mac] spokeswoman Sharon McHale said***. Fannie spokesman Brian Faith declined to comment.

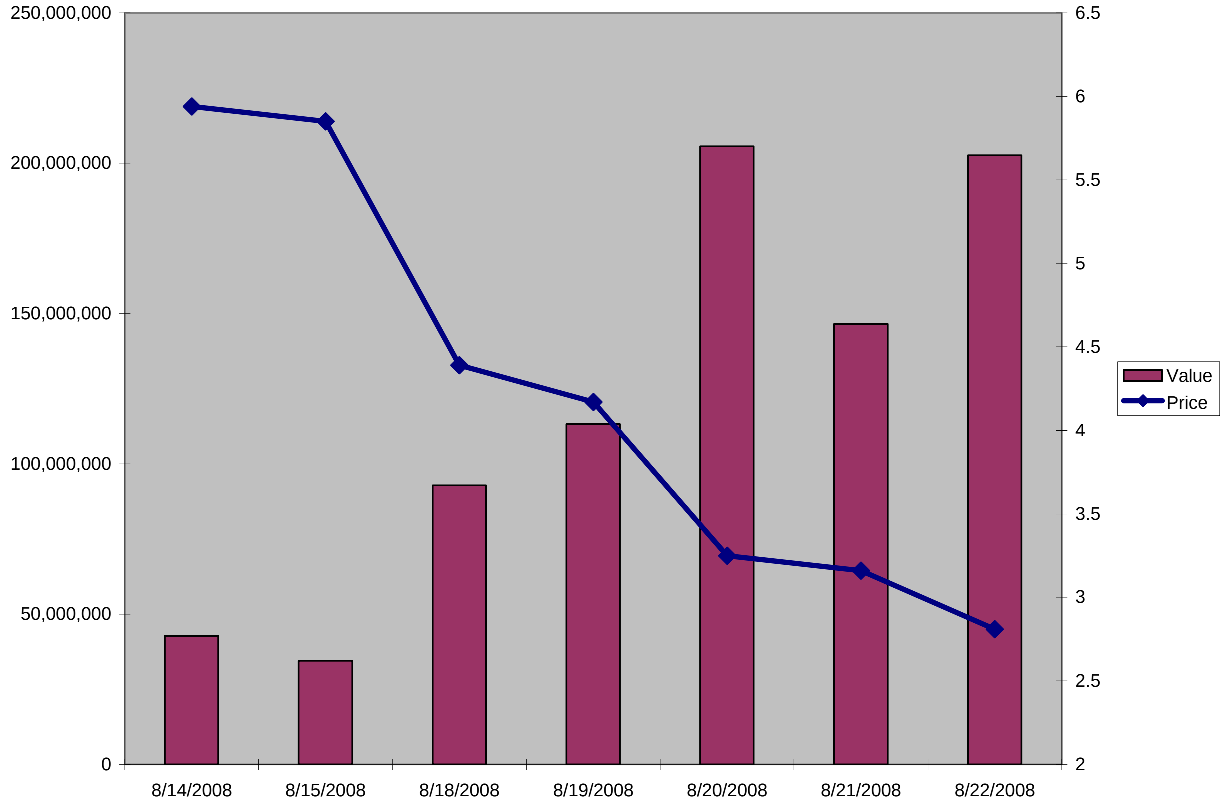
> "Treasury is monitoring market developments vigilantly. We are focused on encouraging market stability, mortgage availability, and protecting the taxpayers' interests," Treasury spokeswoman Jennifer Zuccarelli said.
>
> Freddie Meeting
>
> Freddie executives are scheduled to meet with Treasury officials today, the Wall Street Journal reported, without saying where it obtained the information. The two sides may explore whether the Treasury could clarify its intentions in a way that would reassure investors, the paper said. Zuccarelli told *Bloomberg News* that the department won't confirm particular meetings, and that they receive regular updates from the companies.

559. As a result of the additional partial revelations contained in the *Bloomberg* article, the trading price of Freddie Mac common stock dropped from a close of $4.17 on August 19, 2008 to a close of $3.25 on August 20, 2008 – a drop of approximately 22% on a day when the market was up, not down, while the preferred stock fell by as much as 38%.

560. Two days later, on August 22, 2008, Moody's downgraded the Company's preferred stock to just one notch above junk status. Moody's stated that given recent market movement, Moody's believed Freddie Mac had limited access to common and preferred equity capital at economically attractive terms, and its limited financial flexibility also restricted its ability to pursue its public policy mission of providing liquidity, stability and affordability to the US housing market. It also revealed a greater risk of dividend omission on the preferred stock.

561. In response to this additional partial disclosure, the price of Freddie Mac common stock dropped once more, falling from a prior day close of $3.16 to $2.81, a drop of 11%, while the preferred stock fell by as much as 6.4%, on a day when the market as a whole reported gains, not losses.

562. The partial revelations on August 16, 20, and 22, 2008 caused corresponding losses in the Freddie Mac common stock price, as demonstrated in the chart below:



C. The Truth is Finally Revealed

563. Defendants' massive, ongoing fraud came to a screeching halt in early September 2008, when the U.S. Treasury Department bailed out Freddie Mac. As reported by *MarketWatch* on September 6, 2008:

> The Treasury Department is expected to announce as early as this weekend a plan to bail out and recapitalize collapsing home mortgage giants Fannie Mae and Freddie Mac in one of the biggest government rescues in U.S. history.
>
> Such a plan would end a long downward spiral for the firms, which the government created to help expand home ownership and provide a secondary market for home loans.
>
> Rep. Barney Frank (D.-Mass.) confirmed in a statement Saturday that Treasury Secretary Henry Paulson is set to put the federal government in control of the two troubled mortgage owners. But Frank, who is chairman of the House Financial Services Committee, said he had no details on the intervention plan. Officials at the Treasury Dept. could not be reached for comment.
>
> According to media reports citing unnamed sources close to the negotiations, the government is expected to take at least temporary control of Fannie Mae (FNM) and

> Freddie Mac (FRE) and place the troubled firms under the umbrella of the Federal Housing Finance Agency.
>
> Fannie Mae Chief Executive Daniel Mudd and Freddie Mac CEO Richard Syron are expected to leave their positions soon after the federal bailout is complete.

* * *

564. On September 7, 2008, the largest bailout in U.S. government history occurred, and with stunning finality, Defendants' fraud was completely revealed to the market. On that day, the *New York Times* issued an articled entitled, "Mortgage Giants Agreeable to Rescue Plan, But Its Cost Is Unknown," which reported, in part:

> ***Fannie Mae and Freddie Mac agreed on Saturday afternoon to the Bush administration's plan to rescue them***, people briefed on the plan said. Under the plan, the Treasury Department will buy billions of dollars in new mortgage securities issued by the companies and inject an unknown amount of capital into them in quarterly installments, according to these people.
>
> ***On Sunday, the government plans to announce that it will take control of the mortgage finance giants, remove the top executives and their boards, and appoint a conservator to begin to nurse them back to health***. Senior government officials including Treasury Secretary Henry M. Paulson Jr., Federal Reserve Chairman Ben S. Bernanke, and James Lockhart, the top regulator for the companies, informed their top executives about the plan in meetings on Friday and Saturday.
>
> ***The moves by the Bush administration hold the prospect of becoming the biggest government-funded bailout of private industry in American history***. They would put the federal government in control of institutions that finance or guarantee about half of all the mortgages in the country.

* * *

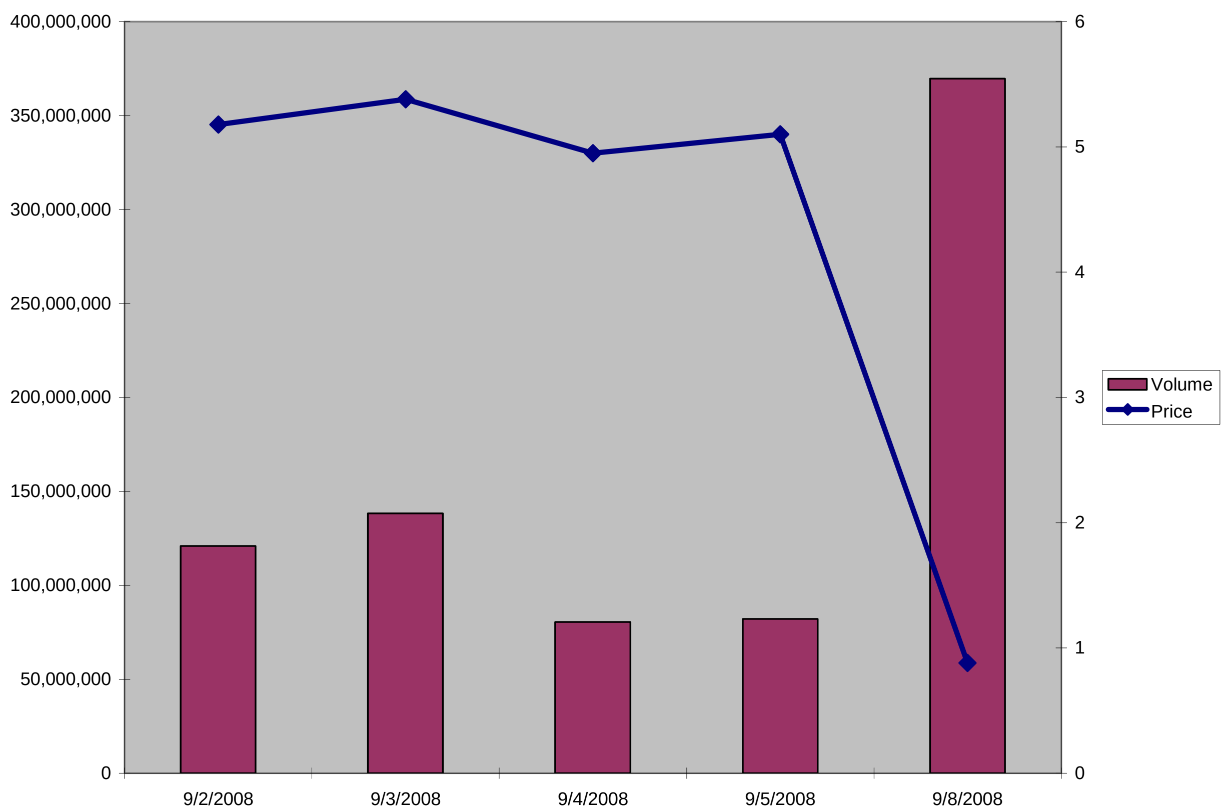
> ***The government, which will replace the top management and boards of both companies, is hoping to restore the health of the companies***. Treasury officials have assured lawmakers that at least for the short term, they intend to make Fannie and Freddie as strong as possible so they can help pull the housing market out of its slump.
>
> ***But shareholders of both companies will suffer. The companies would stop paying any dividends on their common shares, and any new capital provided by the Treasury Department would have financial priority over the existing preferred and common stock***.

* * *

***Using money from the Treasury Department to rebuild the companies' capital cushions would make them stronger and reduce some of the uncertainty about their prospects*.**

* * *

565. The prices of Freddie Mac securities never recovered from the impact of Defendants' fraud. After Freddie Mac was placed into conservatorship, on September 8, 2008 (the next trading day), Freddie Mac common stock fell to $0.88 per share, down approximately ***83%*** from the prior day's closing price of $5.10, on volume of more than 365,000,000 shares, as demonstrated below:



566. ***By bottoming out at $0.88 per share, the common stock had dropped nearly 98% from its Class Period high***. Similarly, on September 8, 2008, the preferred shares plummeted by as much as ***86%***, from the prior day's closing price.

567. As indicated above, as numerous partial revelations of Freddie Mac's true financial condition and future business prospects were revealed to the market, a picture of the extent of Defendants' fraud and false and misleading financial reporting emerged. While Defendants' misrepresentations dealt with several topics – primarily the Company's exposure to non-traditional and non-prime mortgages and the adequacy of its capital, a common underlying purpose and pattern connected them all. The Defendants' motivation was to artificially inflate the price of Freddie Mac's equity securities, thus manipulating market expectations and misleading the market into believing that Freddie Mac's business and financial prospects were first-rate, causing the market to expect and anticipate that Freddie Mac was primed to weather the storm. It is thus reasonable to infer that all of Defendants' misrepresentations and omissions were designed to and, in fact, did contribute to misleading market expectations. Thus, when the price of the Company's equity securities dropped upon revelation of Freddie Mac's true financial condition concealed by the fraud, Plaintiffs and the Class suffered losses proximately caused by Defendants' fraud.

IX. APPLICABILITY OF THE PRESUMPTION OF RELIANCE: FRAUD ON THE MARKET DOCTRINE

568. At all relevant times, the market for Freddie Mac equity securities was an efficient market for the following reasons, among other things:

(a) Freddie Mac's equity securities met the requirements for listing, and were listed and actively traded on the NYSE, a highly efficient and automated market; and

(b) Freddie Mac regularly communicated with public investors via established market communication mechanisms, including through regular disseminations of press releases on the national circuits of major newswire services and through other wide-ranging public disclosures, such as communications with the financial press and other similar reporting services.

569. As a result, the market for Freddie Mac equity securities promptly digested current information regarding Freddie Mac from all publicly-available sources and reflected such information in Freddie Mac's equity securities prices. Under these circumstances, all purchasers of Freddie Mac equity securities during the Class Period suffered similar injury through their purchase of Freddie Mac's equity securities at artificially inflated prices and a presumption of reliance applies.

X. LOSS CAUSATION

570. During the Class Period, as detailed herein, Defendants engaged in a scheme to deceive the market and a course of conduct that artificially inflated the value of Freddie Mac equity securities and operated as a fraud or deceit on Class Period purchasers of Freddie Mac equity securities by misrepresenting the Company's business success and future business prospects, including but not limited to misrepresentations regarding the Company's true exposure to non-prime/non-traditional mortgage loans, its capital adequacy, as well as its financial reporting.

571. As a result of Defendants' fraudulent conduct as alleged herein, the prices at which Freddie Mac equity securities traded were artificially inflated, at varying levels, throughout the Class Period. When Plaintiffs and other members of the Class purchased their Freddie Mac equity securities, the true value of such equity securities was substantially lower than the prices actually paid by Plaintiffs and the other members of the Class.

572. During the Class Period, Defendants improperly concealed the true reasons behind Freddie Mac's financial performance and outlook, and future business prospects. Consequently, the price of its equity securities was artificially inflated throughout the Class Period. Defendants also misrepresented the reasons behind Freddie Mac's reported results and made numerous false and misleading statements regarding many aspects of its business, including, but not limited to, its non-prime/non-traditional loan exposure and the impact such exposure would have on the Company's capital adequacy. Later, however, when the truth regarding Freddie Mac's true financial

circumstances leaked out through a series of partial disclosures, and Defendants' prior misrepresentations and fraudulent conduct became apparent to the market, the prices of Freddie Mac's equity securities fell as the prior artificial inflation was removed from their share price. As a result of their purchases of Freddie Mac equity securities during the Class Period at artificially inflated prices, Plaintiffs and other members of the Class suffered economic loss, *i.e.*, damages under federal securities laws, when such artificial inflation dissipated.

573. By misrepresenting the success of the Company's business and concealing its improprieties, Defendants presented a misleading picture of Freddie Mac's business and prospects. For example, Defendants' oft repeated mantra that the Company was adequately capitalized and always maintained the ability to raise additional capital, if needed, caused and maintained the artificial inflation in the prices of Freddie Mac's equity securities throughout the Class Period, even as negative news reached the market, until the truth was finally revealed at the close of the Class Period.

574. As a result of Defendants' materially false and misleading statements and documents, as well as the adverse, undisclosed information known to the Defendants, Plaintiffs and other members of the Class relied, to their detriment on such statements and documents, and/or the integrity of the market, in purchasing their Freddie Mac equity securities at artificially inflated prices during the Class Period. Had Plaintiffs and the other members of the Class known the truth, they would not have taken such actions.

575. As explained herein, these false statements directly or proximately caused, or were a substantial contributing cause, of the damages and economic loss suffered by Plaintiffs and other members of the Class, and maintained the artificial inflation in the prices of Freddie Mac's equity

securities throughout the Class Period and until the truth leaked into and was partially revealed to the market, at which time the prior inflation came out of those equity securities.

576. Defendants' false and misleading statements had the intended effect and directly and proximately caused, or were a substantial contributing cause, of Freddie Mac's equity securities trading at artificially inflated levels throughout the Class Period.

577. Through a series of partial disclosure events regarding the Company's financial outlook and future business prospects, which culminated in the federal government's takeover of the Company, the artificial inflation came out of the prices of Freddie Mac's equity securities in fits and spurts. These events and disclosures, set forth more specifically above, included numerous news articles discussing the Company's potential capital inadequacy and inability to raise new capital that were published between July 3 and July 10, 2008, causing common stock drops of 8.9%, 17.9%, 23.8%, and 22%, as well as preferred stock drops of as much as 6%, 28%, 8, and 21%. They also included a number of revelations between July 13 and July 15, 2008, when the trading price of Freddie Mac common stock dropped 8.6% on July 14, 2007 and by 26% on July 15, 2008, with the preferred stock dropping by as much as 14% and 16% on those dates.

578. Defendants, however, combated and mitigated the impact of these partial revelations in a further attempt to mislead the market's expectations for the Company by, among other things, insisting it "absolutely" had sufficient capital. Defendants were successful, increasing the Freddie Mac common stock price to close at $10.80 on July 23, 2008, and causing the price of the preferred stock to increase by as much as 22.71% on that same date.

579. Additional partial revelations of the Company's financial condition and future business prospects continued, as set forth above, causing a common stock price decline of 19% on August 6, 2008, when the common stock closed at $6.49, with an additional drop on August 7, 2008

of 9% to close at $5.89 per share. Likewise, the preferred shares fell as much as 11% and 10% on those dates. Following additional partial revelations on August 16, 20, and 22, 2008, the trading price of Freddie Mac common stock fell 25%, 22%, and 11%, respectively, closing at $2.81, with the preferred shares falling as much as 26%, 38%, and 6.4%. From this point on, the trading price of Freddie Mac common stock remained stagnant as a result of Defendants' statements that the Company could stave of a government bailout, among other false and misleading statements. Nevertheless, the market's expectations were ultimately corrected between September 6 and 7, 2008, when it was announced Freddie Mac would be taken over by the U.S. government. The result on the trading price of Freddie Mac common stock was catastrophic, as it fell by as much as ***83%***, representing a decline of as much as ***98%*** from its Class Period high. Likewise, the preferred shares fell as much as ***87%***.

580. The timing and magnitude of the declines in Freddie Mac equity securities negates any inference that the loss suffered by Plaintiffs and other Class members were caused by changed market conditions, macroeconomic or industry factors or Company-specific facts unrelated to the Defendants' fraudulent conduct. The economic loss, *i.e.*, damages, suffered by Plaintiffs and other members of the Class was a direct result of Defendants' fraudulent scheme to artificially inflate the price of Freddie Mac equity securities and their subsequent decline in value as Defendants' prior misrepresentations and other ongoing fraudulent conduct were revealed, market expectations were corrected, and the artificial inflation came out of Freddie Mac's equity securities.

581. In addition, the price of Freddie Mac equity securities was a natural and probable consequence of Defendants' fraud and should have been foreseen by Defendants in light of the attending circumstances. The market reactions to the partial disclosure of Freddie Mac's true

financial condition and future business prospects were foreseeable to Defendants and well within the "zone of risk" concealed by Defendants' fraudulent conduct.

XI. NO SAFE HARBOR

582. The federal statutory safe harbor provided for forward-looking statements under certain circumstances does not apply to any of the allegedly false statements pleaded in this complaint. Many of the specific statements pleaded herein were not identified as "forward-looking statements" when made. To the extent there were any forward-looking statements, there were no meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the purportedly forward-looking statements. Alternatively, to the extent that the statutory safe harbor does apply to any forward-looking statements pleaded herein, Defendants are liable for those false forward-looking statements because at the time each of those forward-looking statements was made, the particular speaker knew that the particular forward-looking statement was false, and/or the forward-looking statement was authorized and/or approved by an executive officer of Freddie Mac who knew that those statements were false when made. Moreover, to the extent that Defendants issued any disclosures designed to "warn" or "caution" investors of certain "risks," those disclosures were also false and misleading since they did not disclose that Defendants were actually engaging in the very actions about which they purportedly warned and/or had actual knowledge of material adverse facts undermining such disclosures.

XII. COUNT I: FOR VIOLATIONS OF SECTION 10(b) OF THE EXCHANGE ACT AND RULE 10b-5 PROMULGATED THEREUNDER AGAINST ALL DEFENDANTS

583. Plaintiffs repeat and reallege the allegations set forth above as though fully set forth herein. This claim is asserted against all Defendants.

584. During the Class Period, Freddie Mac and the Individual Defendants, and each of them, carried out a plan, scheme and course of conduct which was intended to and, throughout the

Class Period, did: (i) deceive the investing public, Plaintiffs and other Class members, as alleged herein; (ii) artificially inflate and maintain the market price of Freddie Mac equity securities; and (iii) cause Plaintiffs and other members of the Class to purchase Freddie Mac equity securities at artificially inflated prices. In furtherance of this unlawful scheme, plan and course of conduct, Freddie Mac and the Individual Defendants, and each of them, took actions set forth herein.

585. These Defendants: (i) employed devices, schemes, and artifices to defraud; (ii) made untrue statements of material fact and/or omitted to state material facts necessary to make the statements not misleading; and (iii) engaged in acts, practices, and a course of business which operated as a fraud and deceit upon the purchasers of the Company's equity securities in an effort to maintain artificially high market prices for Freddie Mac's equity securities in violation of Section 10(b) of the Exchange Act and Rule 10b-5. These Defendants are sued as primary participants in the wrongful and illegal conduct charged herein. The Individual Defendants are also sued as controlling persons of Freddie Mac, as alleged below.

586. In addition to the duties of full disclosure imposed on Defendants as a result of their making of affirmative statements and reports, or participating in the making of affirmative statements and reports, or participating in the making of affirmative statements and reports to the investing public, they each had a duty to promptly disseminate truthful information that would be material to investors in compliance with the integrated disclosure provisions of the SEC as embodied in SEC Regulation S-X (17 C.F.R. § 210.01 *et seq.*) and S-K (17 C.F.R. §229.10 *et seq.*) and other SEC regulations, including accurate and truthful information with respect to the Company's operations, surveillance, financial condition and operational performance, so that the market prices of Company equity securities would be based on truthful, complete and accurate information.

587. Freddie Mac and each of the Individual Defendants, individually and in concert, directly and indirectly, by the use, means or instrumentalities of interstate commerce and/or of the mails, engaged and participated in a continuous course of conduct to conceal adverse material information about the business, business practices, performance, operations and future prospects of Freddie Mac as specified herein.

588. These Defendants each employed devices, schemes and artifices to defraud, while in possession of material adverse non-public information and engaged in acts, practices, and a course of conduct as alleged herein in an effort to assure investors of Freddie Mac's value and performance, financial and operational growth, which included the making of, or the participation in the making of, untrue statements of material facts and omitting to state necessary facts in order to make the statements made about Freddie Mac and its business operations and future prospects in light of the circumstances under which they were made, not misleading, as set forth more particularly herein, and engaged in transactions, practices and a course of business which operated as a fraud and deceit upon the purchasers of Freddie Mac equity securities during the Class Period.

589. Each of the Individual Defendants' primary liability, and controlling person liability, arises from the following facts: a) each of the Individual Defendants was a high-level executive and/or director at the Company during the Class Period; b) each of the Individual Defendants, by virtue of his/her responsibilities and activities as a senior executive officer and/or director of the Company, was privy to and participated in the creation, development and reporting of the Company's financial performance, projections and/or reports; and c) each of the Individual Defendants was aware of the Company's dissemination of information to the investing public which each knew or disregarded with severe recklessness was materially false and misleading.

590. Each of these Defendants had actual knowledge of the misrepresentations and omissions of material facts set forth herein, or acted with severely reckless disregard for the truth in that each failed to ascertain and to disclose such facts, even though such facts were available to each of them. Such Defendants' material misrepresentations and/or omissions were done knowingly or with severe recklessness and for the purpose and effect of concealing Freddie Mac's operating condition and future business prospects from the investing public and supporting the artificially inflated price of its equity securities. As demonstrated by Defendants' misstatements of the Company's financial condition and performance throughout the Class Period, each of the Individual Defendants, if he or she did not have actual knowledge of the misrepresentations and omissions alleged, was severely reckless in failing to obtain such knowledge by deliberately refraining from taking those steps necessary to discover whether those statements were false and misleading.

591. As a result of the dissemination of the materially false and misleading information and failure to disclose material facts, as set forth above, the market prices of Freddie Mac's equity securities were artificially inflated, at varying levels, throughout the Class Period. In ignorance of the fact that market prices of Freddie Mac equity securities were artificially inflated, and relying directly or indirectly on the false and misleading statements made by Defendants, or upon the integrity of the market in which the equity securities trade, and/or on the absence of material adverse information that was known to or disregarded with severe recklessness by Defendants but not disclosed in public statements by Defendants during the Class Period, Plaintiffs and the other members of the Class acquired Freddie Mac equity securities during the Class Period at artificially high prices and were damaged thereby, as evidenced by, among others, the stock price declines identified herein that released the artificial inflation from Freddie Mac's equity securities.

592. At the time of said misrepresentations and omissions, Plaintiffs and other members of the Class were ignorant of their falsity, and believed them to be true. Had Plaintiffs and the other members of the Class and the marketplace known of the true performance, future prospects and intrinsic value of Freddie Mac, which were not disclosed by Defendants, Plaintiffs and other members of the Class would not have purchased or otherwise acquired their Freddie Mac equity securities during the Class Period, they would not have done so at artificially inflated prices which they paid.

593. By virtue of the foregoing, Freddie Mac and the Individual Defendants have each violated Section 10(b) of the Exchange Act, and Rule 10b-5 promulgated thereunder.

594. As a direct and proximate result of Defendants' wrongful conduct, Plaintiffs and the other members of the Class suffered damages in connection with their respective purchases and sales of the Company's equity securities during the Class Period, as evidenced by, among others, the stock price declines identified herein that released the artificial inflation from Freddie Mac's equity securities.

XIII. COUNT II: FOR VIOLATIONS OF SECTION 20(a) OF THE EXCHANGE ACT AGAINST THE INDIVIDUAL DEFENDANTS

595. Plaintiffs repeat and reallege the allegations set forth above as though fully set forth herein. This claim is asserted against the Individual Defendants.

596. Each of the Individual Defendants acted as a controlling person of Freddie Mac within the meaning of Section 20(a) of the Exchange Act as alleged herein. By virtue of their high-level positions with the Company, participation in and/or awareness of the Company's operations and/or intimate knowledge of the Company's fraudulent financial reporting and actual performance, each of the Individual Defendants had the power to influence and control and did influence and control, directly or indirectly, the decision-making of the Company, including the content and

dissemination of the various statements which Plaintiffs contend are false and misleading. Each of the Individual Defendants was provided with or had unlimited access to copies of the Company's reports, press releases, public filings and other statements alleged by Plaintiffs to be misleading prior to and/or shortly after these statements were issued and had the ability to prevent the issuance of the statements or cause the statements to be corrected.

597. In addition, each of the Individual Defendants had direct involvement in the day-to-day operations of the Company and, therefore, is presumed to have had the power to control or influence the particular transactions giving rise to the securities violations alleged herein, and exercised the same.

598. As set forth above, Freddie Mac and the Individual Defendants each violated Section 10(b) and Rule 10b-5 by their acts and omissions as alleged in this Complaint. By virtue of their controlling positions, each of the Individual Defendants is liable pursuant to Section 20(a) of the Exchange Act. As a direct and proximate result of Defendants' wrongful conduct, Plaintiffs and other members of the Class suffered damages in connection with their purchases of the Company's equity securities during the Class Period, as the artificial inflation dissipated from Freddie Mac equity securities.

WHEREFORE, Plaintiffs pray for relief and judgment, as follows:

(a) Determining that this action is a proper class action and designating Plaintiffs as class representatives under Rule 23 of the Federal Rules of Civil Procedure;

(b) Awarding compensatory damages in favor of Plaintiffs and the other Class members against all Defendants, jointly and severally, for all damages sustained as a result of Defendants' wrongdoing, in an amount to be proven at trial, including interest thereon;

(c) Awarding Plaintiffs and the Class their reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and

(d) Such other and further relief as the Court may deem just and proper.

XIV. JURY TRIAL DEMANDED

599. Plaintiffs hereby demand a trial by jury.

DATED: May 19, 2009

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing was sent by U.S. Mail to the following persons on May 19, 2009:

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EXHIBIT A

09/07/2004 04:41 PM
To: Dick Syron [redacted] Mike May [redacted] Robert
Tsien [redacted] Patricia Cook [redacted] Clarke D
Campe [redacted] Susan W Gates [redacted]
cc: David A Andrukonis [redacted]
Subject: No Income/No Asset(NINA) Mortgages

The purpose of this e-mail is to document my recommendation regarding NINA mortgages. I've come to my conclusion after studying data from three major lenders and comparing notes with other risk managers in the industry. Mike May and Bob Tsien are working to get this issue before you formally in the near future.

Recommendation

Freddie Mac should withdraw from the NINA market as soon as practicable. Our presence in this market is inconsistent with a mission-centered company and creates too much reputation risk for the firm.

Background

The NINA mortgage was created over 20 years ago as a way of serving borrowers with inconsistent income patterns (actors, the self employed, etc.) but strong credit profiles and downpayments. In addition, the product served borrowers who, for whatever reason, did not want to report their income. Over time, other mortgage products and underwriting practices evolved, making NINA mortgages less common. Specifically, Freddie Mac's Loan Prospector and other automated underwriting services began to recognize that income was less predictive of default than previously thought, and consequently traditional guidelines around housing expense to income ratios were eased. Other mortgage products, such as stated income/stated asset (SISA) mortgages, arose that accommodated borrowers who didn't want to be hassled with providing their income.

The NINA product we are being sold today differs substantially in the niche it is trying to reach. Today's NINA appears to target borrowers who would have trouble qualifying for a mortgage if their financial position were adequately disclosed. The best evidence of this is the first year delinquency rates on these mortgages, which range from 8 to 13%, depending on the lender. We conducted a quality control review of NINA loan files and found that nearly two-thirds of the time a spouse was dropped from the note. This means that the borrower with the weaker credit score was probably not adequately considered in the underwriting process. Our underwriting system uses credit data from both spouses, when available, because we have found the weaker borrower to be predictive of default. Typically, borderline borrowers need both incomes to meet minimum income thresholds. However, since, by definition, NINA mortgage underwriting ignores income, originators can advise spouses with weaker credit to only include the stronger of the two borrowers on the application.

An additional problem with these mortgages is that it appears they are disproportionately targeted towards Hispanics. The potential for the perception and the reality of predatory lending with this product is great. In 2003, 5.5% of Freddie Mac single-family loans were made to Hispanics. This compares with 18% of the NINA type loans we sampled that went to Hispanics.

The HMDA data paint a similar picture with 16% of no income documentation loans going to Hispanics, versus 10% of total conforming mortgages.

Exiting the NINA market would be difficult and expensive, but there is also an opportunity. Certainly lenders would criticize us because our withdrawal might affect their margins on this business. Freddie Mac would also stand to lose $25 to 50 million in annual profits. Finally, since NINA loans are minority rich, it will make it even more difficult to match the private market level of minority and underserved mortgage production.

On the other hand, what better way to highlight our sense of mission than to walk away from profitable business because it hurts the borrowers we are trying to serve? What better way to highlight the problem with linking the assessment of our progress to hitting the HMDA data? In my judgment, matching the market's production of underserved and minority borrowers will require us to engage in market practices that are at odds with our charter if it requires us to make a market in NINA mortgages.

EXHIBIT B

From: David A Andrukonis
Sent: Wednesday, September 8, 2004 9:26 AM
To: Mike May
Subject: Re: No Income/No Asset(NINA) Mortgages

Mike,

At last week's risk management meeting I mentioned that I had reached my own conclusion on this product from a reputation risk perspective. I said that I thought you and/or Bob Tsien had the responsibility to bring the business recommendation to Dick, who was going to make the decision. Marty and Patti asked me what it meant that I opposed this product. I said that my job was to speak out to Dick and then to the Board if I thought we were in the wrong place on business or reputation risk. I think of this letter as comparable to the one Don B sent Paul. What I want Dick to know is that he can approve of us doing these loans, but it will be against my recommendation. I wouldn't be surprised if he disagrees with my conclusion. The "as soon as practicable" phrase was to reflect the fact that business realities may dictate the timing of our action, even if you agree with my position. I think I would wait for the business if it were a line we were contemplating entering. But since we've been in this one for some time, I think I should speak as soon as I reach a conclusion. In writing it I actually felt more like I was late. Let's talk.

DA

Mike May
09/07/2004 06:43 PM
To: David A Andrukonis[redacted]
cc:
Subject: Re: No Income/No Asset(NINA) Mortgages

Wow.

This seems a bit premature. I am not sure what you are trying to accomplish......I would have expected you to wait until we had made a decision and a firm recommendation and then perform an oversight role on that decision.

I will call you and discuss this when we both have a chance.

Mike May
Mortgage Sourcing, Operations and Funding
Committed to Integration and Execution
Office: [redacted]
Fax: [redacted]
Cell: [redacted]

David A Andrukonis
Sent by: Donna L Cogswell

EXHIBIT C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

JINO KURIAKOSE, Individually and On Behalf of All Others Similarly Situated, Plaintiff,	:	Civil Action No. 1:08-cv-7281 (JFK)
vs.	:	**DECLARATION OF EDWARD PINTO IN SUPPORT OF PLAINTIFFS' CONSOLIDATED CLASS ACTION COMPLAINT FOR VIOLATIONS OF FEDERAL SECURITIES LAWS**
FEDERAL HOME LOAN MORTGAGE COMPANY, RICHARD SYRON, PATRICIA L. COOK, and ANTHONY S. PISZEL, Defendants.	:	

I, Edward Pinto, declare:

1. I served as the Chief Credit Officer of Federal National Mortgage Association ("Fannie Mae") from 1987 until 1989. I also worked as the head of marketing and product management at Fannie Mae for approximately 3 years. Prior to starting at Fannie Mae in 1984, I had 10 years experience in affordable housing. Since leaving Fannie Mae, I have worked as a real estate financial services consultant, and closely followed the performance of Fannie Mae and Freddie Mac.

2. I was retained by Coughlin Stoia Geller Rudman & Robbins LLP ("Coughlin Stoia"), Lead Counsel on behalf of the proposed class in a case pending against the Federal Home Loan Mortgage Company and certain of its officers and directors ("Freddie Mac" or the "Company"), styled *Kuriakose v. Federal Home Loan Mortgage Co., et al.*, to assist in analyzing factual information on behalf of plaintiffs.

3. I submit this Declaration in support of the factual allegations set forth in and underlying Plaintiffs' Consolidated Class Action Complaint for Violations of Federal Securities Laws (the "Consolidated Complaint").

4. I am familiar with the nature of the securities fraud alleged in this case, by reviewing the news articles and other public information, as well as the Consolidated Complaint.

5. On Tuesday, December 9, 2008, I testified before the U.S. House of Representatives Committee on Oversight and Government Reform (the "Committee") during a hearing referred to as "The Role of Fannie Mae and Freddie Mac in the Financial Crisis."

6. In preparation for my testimony, I reviewed a number of public and non-public internal documents concerning Freddie Mac provided to me by the Committee staff. These documents are from the period starting in the first quarter of 2004 and continued through the first quarter of 2007. Coughlin Stoia has been unable to obtain the non-public internal documents

concerning Freddie Mac and I have not provided such non-public internal documents to Coughlin Stoia. I also conducted substantial additional research concerning the performance of Freddie Mac and its level of involvement in and contribution to the size of the subprime and non-prime mortgage market.

7. In my testimony to the Committee, I stated there can be no doubt that Freddie Mac and Fannie Mae collectively now own or guarantee $1.6 trillion in subprime, Alt-A, and other default-prone loans and securities. Contrary to Freddie Mac's public statements in 2007 and 2008, these loans comprised more than one-third of its risk portfolio, not the 15% it publicly referred to. I provided the Committee a detailed explanation of my methodology whereby I concluded that as of mid-2008, Freddie Mac and Fannie Mae were collectively responsible for 34% of all the outstanding subprime loans made in the United States and 59% of all the outstanding Alt-A loans made in the United States. I testified that Freddie Mac's and Fannie Mae's purchases of subprime and non-prime mortgages and securities were a major factor in the development of the housing bubble and in the huge number of defaulted mortgages now causing massive declines in house prices.

8. Based on my research and analysis, I concluded Freddie Mac had $650.5 billion in subprime, Alt-A, and other default prone loans and securities, amounting to 35% of its total credit risk exposure as of December 31, 2007. A percentage close to this level continued through 2008. Recent disclosures by the Company during March 2009 confirmed my conclusions.

9. My review of public and non-public internal Freddie Mac materials supports my conclusion that the Company and its representatives' statements during the November 20, 2007 through September 7, 2008 time period regarding the extent of the Company's exposure to subprime and non-prime loans and securities are not supported by the facts and the extent of Freddie Mac's exposure to subprime and non-prime loans and securities was substantially greater than indicated by

the Company and its representatives' public statements. The effect of these misrepresentations and minimizations was to misrepresent to the public the impact of these loans on the Company's financial circumstances.

I declare under penalty of perjury that the foregoing is true and correct. Executed this 18th day of May, 2009 at Bethesda, Maryland.

EDWARD PINTO